Supreme Court, U.S.
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No. 01-

IN THE
Supreme Court of the United States

RICK'S AMUSEMENT, INC., *et al.*,

Petitioners,

v.

STATE OF SOUTH CAROLINA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF SOUTH CAROLINA

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Are firms in heavily-regulated sectors categorically barred from establishing cognizable property interests under the Takings and Contracts Clauses, even when their businesses may be totally dependent on regulatory licensing?

LIST OF PARTIES BELOW AND RULE 29.6 STATEMENT

The petitioners not listed in the caption are: Leslie Mart, Inc.; B&B Amusement; Tripp's Amusement Co.; Fascination of South Carolina; Britt's Inc. (d/b/a Tripp's Convenience); Crenshaw Technology, Inc.; Southern Amusements; Ballard Amusements, Inc.; Wilkinson Fuel Co. (d/b/a Nu-Way Marketing); Greenwood Music Co., Inc.; McDonalds Amusements, Inc., Cherokee Trail; Sonoco Amusements; and JSW Amusement.

None of the corporate parties have a parent company or any publicly held company owning 10% or more of stock.

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Petitioners, Rick's Amusement, Inc., *et al.*, respectfully pray that a writ of certiorari issue to review the November 5, 2001, opinion and judgment of the Supreme Court of South Carolina in the above-captioned proceeding.

OPINIONS BELOW

The opinion and judgment of the Supreme Court of South Carolina, *Rick's Amusement, Inc. v. South Carolina*, No. 25359 (S.C. Nov. 5, 2001), is currently unreported, and is reprinted at App. 1a. This opinion, prompted by a Petition for Rehearing, *see* Pet. App. 2a, superseded an earlier opinion issued on September 10, 2001, which appears at 2001 WL 1167790 (S.C. Sept. 10, 2001). The trial court's Order of Dismissal in the Court of Common Pleas of Richland County, Hon. Kenneth G. Goode presiding, dated May 9, 2000, C/A No. 99-CP-40-4503, is unreported but is reprinted at App. 13a.

STATEMENT OF JURISDICTION

Petitioners seek review from the opinion and judgment of the Supreme Court of South Carolina of November 5, 2001. The Supreme Court has jurisdiction to review cases from state courts by virtue of 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

This case raises questions about the scope of cognizable property rights for purposes of the Takings and Contracts Clauses of the Constitution. Article I, section 10, clause 1 of the Constitution provides in pertinent part that "No State . . . shall pass any . . . Law impairing the Obligation of Contracts. . . ." The Fifth Amendment of the United States Constitution provides in pertinent part that "private property [shall not] be taken for public use without just compensation."

South Carolina's Video Game Machines Act, S.C. Code Ann. § 12-21-2770, *et seq.* (Supp. 1995), including the Local Option Video Gaming Law, S.C. Code Ann. § 12-21-2806 (Supp. 1995), are reprinted in the Appendix at App. 30a.

STATEMENT OF THE CASE

1. This Petition concerns the extent to which governments may interfere with legitimate investment-backed expectations of property owners, compensable under the Takings and Contracts Clauses of the federal and state constitutions, even when the affected industries are heavily-regulated. This particular case arises in the context of South Carolina businesses engaged in the provision of coin-operated video games and related forms of amusements. In particular, the South Carolina Supreme Court has held that a highly-regulated industry has no cognizable property rights under the Takings and Contracts Clauses, even when illegal state actions rendered worthless existing contracts involving regulated activity.

Although South Carolina's regulation of coin-operated video amusements dates back to 1962, *see* 1962 S.C. Code § 16-505.1 (codified at S.C. Code Ann. § 16-19-60) and 1986, *see* 1986 S.C. Acts No. 308, § 4 (codified at S.C. Stat. Ann. § 12-21-2710 (2000)), for purposes of the present case the crucial piece of legislation is the 1993 Video Games Machine Act, 1993 S.C. Acts No. 164, Part II, § 19A (codified at S.C. Stat. Ann. § 12-21-2770, *et seq.* (2000), and reprinted in pertinent part at App. 30a). The 1993 Act sought to regulate aspects of video gaming in South Carolina, by providing incredibly detailed specifications and configurations for acceptable coin-operated machines. *See id.* §§ 12-21-2774; App. 32a ("Mechanical requirements of machines"), 12-21-2782; App. 35a ("Standards for licensed video game machines"), 12-21-2783; App. 36a ("Location controller and

modem; requirements"), 12-21-2791; App. 41a ("Limit on cash payout for credits earned for free games") (all sections repealed effective July 1, 2000). The 1993 Act established rules for licensing of the operators, distributors and manufacturers of the machines. *See id.* §§ 12-21-2776, 12-21-2778, 12-21-2780, 12-21-2784 (all repealed effective July 1, 2000). Lastly, the 1993 Act provided for the practical enforcement and criminal penalties in relation to its substantive provisions. *See id.* §§ 12-21-2788. 12-21-2790, 12-21-2792, 12-21-2794, 12-21-2797, 12-21-2805 (repealed effective July 1, 2000).

In addition to establishing the regulatory framework for the operation of the video game industry, the South Carolina legislature also provided in the 1993 Act for a local option referendum on allowing non-machine cash payouts from video games.[1] For those South Carolina counties that voted in favor of such continued services, they would "remain legal and subject to licensure and regulation by the State of South Carolina." S.C. Code Ann. § 12-21-2806; Pet. App. 52a-53a.

As a result of the referendum held in November 1994, twelve counties voted in favor of prohibiting payouts from video games within their precincts. Under the terms of the 1993 Act, such business operations were banned as of July 1, 1995. *See id.* And although the 1993 Act provided for a *pro rata* refund of any annual license fees paid for the game devices, no other compensation to the affected businesses was allowed by the statute. *See id.*

The constitutionality of the Local Option Video Gaming Law, S.C. Code Ann. § 12-21-2806 (Supp. 1995), was subsequently challenged in the South Carolina courts. In a November 1996 decision, *Martin v. Condon*, 324 S.C. 183, 478

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1. "Non-machine cash payouts" are those, according to South Carolina law, where "the machine [does not] disburse[] money to the player." S.C. Stat. Ann. § 16-19-60.

S.E.2d 272 (1996), the South Carolina Supreme Court ruled that the local option law was unconstitutional, non-uniform special legislation under S.C. CONST. Art. III, § 34. *See* 478 S.E.2d at 275. The adoption of section 12-21-2806 and subsequent referendum was thus an illegal act that had rendered worthless contracts between establishments and operators in the twelve counties for a period of July 1995 until November 1996. As a consequence of the November 1996 decision, cash payouts resumed in the affected South Carolina counties, until July 2000, when (under a later and different statutory scheme) video game amusements were prohibited in the entirety of South Carolina.

2. a. Petitioners are a group of business establishments which offered video games to their customers, as well as providers of the machines, who were affected by the 1993 Act and the total ban on their business activities from July 1995 to November 1996. *See* App. 14a, 21a. These businesses had entered into contracts with video game operators. These agreements typically allowed for the premises owner to provide space for the games (for their customers' amusement), for the operator to maintain the games, and for both parties to share in any revenues produced by the games. In their separate complaints,[2] the businesses alleged that they entered into contracts for the placement of video gaming machines prior to enactment of the local option law and that the law illegally "revoked and/or impounded [their] contracts," constituting a taking without just compensation and an unconstitutional impairment of their contracts, compensable under the federal and state constitutions. *See* App. 4a & n.2; 15a-16a. The plaintiffs sought money damages from the State of South Carolina for the temporary taking of their property, as well for the impairment of their business contracts.

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2. From the outset in the trial court, two cases involving separate sets of plaintiffs but virtually identical claims were consolidated. *See* App. 21a & n.1.

In the Court of Common Pleas for Richland County, the State sought to dismiss the complaint for failure to present a claim under S.C. R. Civ. P. 12(b)(6). The trial court granted the motion, but only on narrow legal grounds and after making certain rulings unfavorable to the State's position. *See* App. 15a, 22a-24a. For example, Judge Goode found that the plaintiff businesses "ha[d] alleged sufficient facts to support a claim of an investment-backed expectation, and thus, [they] did have a compensable property interest sufficient to support a takings action." App. 15a. The trial court thus rejected South Carolina's assertion that the plaintiffs lacked a cognizable property interest in their coin-operated video game machines, and their attendant nexus of contractual relations. Furthermore, the trial court found that the plaintiffs were properly seeking damages for " 'value of the interest taken' (Complaint ¶55), or, simply put, the value of the contract[s]" affected by the unconstitutional ban on their businesses. App. 15a.[3]

The Court of Common Pleas did hold, though, that to the extent that plaintiffs sought to recover for takings and impairment of contracts, South Carolina's jurisprudence categorically barred compensation where the interests affected "depend[] . . . upon regulatory licensing." App. 16a. Feeling constrained by an earlier South Carolina Supreme Court decision, *Mibbs v. Department of Revenue*, 337 S.C. 601, 524 S.E.2d 626 (1999), Judge Goode noted:

> The Supreme Court held that there can be no taking where the subject is a highly regulated area because history makes future regulations foreseeable. *Mibbs* at 628, 629. The Court went

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3. The trial court also rejected the State's reliance on sovereign immunity, legislative immunity, and the South Carolina Torts Claims Act as defenses to the complaints. *See* App. 16a-18a. The State never renewed these defenses, and they are not otherwise before this Court.

> on to say that it does not matter that the regulations are unconstitutional and invalid. *Id.* at 629. Plaintiffs cannot overcome this hurdle. There is little question that the unconstitutional act providing for the referendum made the contracts in question impossible to perform and, in effect, voided them, but there can be no taking or impairment because video poker is a highly regulated area. Therefore, I hold that Plaintiff's action must be dismissed on these grounds.

App. 16a.

b. Both the plaintiffs and the State of South Carolina cross-appealed to the South Carolina Court of Appeals, where the matter was subsequently transferred to the South Carolina Supreme Court for decision.[4] In a published opinion first issued on September 10, 2001, the South Carolina Supreme Court affirmed, but on grounds at slight variance with those articulated by the trial court.

In addressing the plaintiffs' takings claim, the South Carolina Supreme Court affirmed the trial court's ruling that "highly regulated claims are precluded from establish a takings claim," and that no recourse needs to be made to the "standard three-prong takings analysis" of *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104 (1978). App. 54a. Amplifying its earlier decisions in *Mibbs v. Department of Revenue*, 337 S.C. 601, 524 S.E.2d 626 (1999); and *Westside Quik Shop, Inc. v. Stewart*, 341 S.C. 297, 534 S.E.2d 270, *cert. denied*, 531 U.S. 1029 (2000), the South Carolina Supreme Court proceeded to canvass

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4. The State's cross-appeal, challenging the trial court's findings on the plaintiffs' cognizable property interests, was subsequently withdrawn and on November 6, 2000, the South Carolina Supreme Court dismissed that cross-appeal.

federal takings jurisprudence. *See* App. 5a-9a. The South Carolina Supreme Court concluded that courts may dispense with the *Penn Central* test for regulatory takings, and categorically deny those takings claims, where a property owner's rights are "completely dependent upon regulatory licensing." App. 9a (*citing Mibbs*; *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1030 (1992); and *Board of Regents of State Colleges v. Roth*, 408 U.S. 564, 577 (1972)).

In a significant passage, partially re-formulated by the panel in response to a Petition for Rehearing later filed by the appellant businesses, *see* App. 2a, the South Carolina Supreme Court noted:

> The local option law did not "revoke or impound" appellants' contracts which they entered on the assumption cash payouts would continue to be legal. Appellants' rights to continued cash payouts were completely dependent upon regulatory licensing rather than inherent in appellants' right to own or possess video gaming machines. *Mibbs, Inc. v. South Carolina Dep't of Revenue, supra*. Moreover, their rights to operate video gaming machines were completely dependent upon the regulatory licensing scheme rather than inherent in their right to own or possess the machines. *See* § 12-21-28-8(7) (Supp. 1995) (recognizing licensing required for operation of coin-operated devices) [sic]. Appellants' interest in the contracts did not constitute a property interest which could be compensable as a taking. Accordingly, the trial judge did not err by failing to reach the *Penn Central* factors.

App. 9a. The South Carolina Supreme Court thus propounded a categorical exception to all takings claims on the ground that participants in heavily-regulated sectors have no cognizable property interests.

The identical analysis was repeated by the South Carolina Supreme Court in the context of the plaintiffs' impairment of contracts challenge, under both the federal and South Carolina constitutions. South Carolina courts have acknowledged that state and federal constitutional protections under the Contracts Clause are identical. *See* App. 10a (citing *Ken Moorhead Oil Co. v. Federated Mutual Ins. Co.*, 323 S.C. 532, 476 S.E.2d 481 (1996), *which adopted*, 476 S.E.2d at 485, this Court's test in *United States Trust Co. v. New Jersey*, 431 U.S. 1, 17 (1977) and *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978)). Under the first prong of this Court's Contracts Clause analysis, a tribunal "must determine whether the state law has operated as a substantial impairment of a contractual relationship." App. 10a. The South Carolina Supreme Court reasoned that in such a consideration, "[t]he validity of the regulation is irrelevant to this initial determination," App. 10a, and that it simply made no difference that the Local Option Video Gaming Law, S.C. Code Ann. § 12-21-2806 (Supp. 1995), was an illegal and unconstitutional regulation of the claimants' businesses.

The South Carolina Supreme Court went on to rule, extending its earlier decision in *Mibbs*, that the total ban on video games did not operate as an impairment of contract, in violation of the federal and state constitutions:

> the fact that appellants entered into contracts for the placement of video gaming machines before the legislature enacted the local option law is an insignificant distinction from *Mibbs*. In *Mibbs*, the Court acknowledged there is "no substantial impairment of a contract where the subject of the contract is a highly regulated business whose history makes further regulation foreseeable." Id. S.C. at 608, S.E.2d at 629. It concluded the video

> poker industry was highly regulated and, therefore, further regulation regarding cash payouts was foreseeable. Although recognizing the operator had entered into contracts after enactment of the local option law, *Mibbs* was nonetheless decided on the basis of the high degree of regulation in the video gaming industry.

App. 11a. Ostensibly recognizing the broad scope of its ruling, the South Carolina Supreme Court attempted to provide some limiting principle for its Contracts Clause jurisprudence:

> Appellants assert our decision today will affect the reliability of contracts entered into by participants in other highly regulated fields like banking and insurance. We disagree. Throughout the late 1980s and early 1990s, the same time period during which appellants entered into their contracts, lawmakers repeatedly introduced legislation specifically aimed at eliminating nonmachine cash payouts. In this unique environment, appellants could not have reasonably expected that no regulation would interfere with their anticipated cash payouts. Our ruling does not affect the certainty of contracts in highly regulated fields.

App. 11a (footnote omitted). The South Carolina Supreme Court thus seemed to create a degree of regulation test to invoke the principle that highly-regulated industries are barred from establishing cognizable property interests. The court otherwise affirmed the dismissal of the property owners' complaints, and rejected their requests for compensation under the Takings and Contracts Clauses.

c. After the South Carolina Supreme Court's September 10, 2001, decision was issued, the property owners sought a Petition for Rehearing. This was granted on November 5, 2001, the initial opinion was withdrawn, and a slightly revised opinion (as noted above) was substituted. *See* App. 2a. This timely Petition for a Writ of Certiorari follows.

REASONS FOR GRANTING THE WRIT

COURTS ARE DIVIDED ON WHETHER BUSINESSES IN HIGHLY-REGULATED AREAS HAVE THE COGNIZABLE PROPERTY INTERESTS REQUIRED IN TAKINGS AND CONTRACT IMPAIRMENT CASES

This Petition invites the Court to define a significant point of intersection between its takings and impairment of contracts jurisprudence. At issue is an emerging trend in both state and federal courts to short-circuit this Court's traditional protections of property rights through recourse to a categorical denial of the applicability of the protections afforded by the Takings and Contracts Clauses, U.S. CONST. Art. I, § 10, cl. 1; Amend. V, by refusing to give any recognition to the property interests of businesses in what a court might characterize as a "highly-regulated" industry. The decision in the judgment below is only the most recent manifestation of a growing willingness of courts to subvert established principles in takings and contract impairment cases by simply ruling that those firms that participate in highly-regulated areas of the economy can have no cognizable property rights protected under the Constitution. Such a sweeping rule raises the specter, much like the "nuisance" exception to takings claims laid to rest by this Court's decision in *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992), of a wholesale repudiation of fundamental protections for property rights in this country.

Three distinct pathologies are implicated in the South Carolina Supreme Court's decision, from which review is sought here. Each arises from, and reflects, divergent case law from this and lower courts. Each raises a potential challenge to the coherence and integrity of this Court's property rights jurisprudence. The first problem raised by the ruling below is whether, as the South Carolina Supreme Court ruled, App. 5a-9a, it is even proper to define a takings claimant's cognizable property rights outside the scope of the *Penn Central* test. The second flaw manifest in the decision below is its categorical exclusion of claims arising from highly-regulated industries, even to the extent this is confined to situations where the underlying property interests are "completely dependent on regulatory licensing." App. 9a. The third fallacy reflected in the South Carolina Supreme Court's ruling is its merger of takings and contract impairment idioms, *see* App. 10a, with the result of collapsing what should be distinctive constitutional inquiries and rendering them largely redundant based on the finding that a business is engaged in "highly-regulated" activities.

1. The crucial question propounded in this Petition is whether courts may raise a categorical bar to takings and contracts claims by concluding that businesses engaged in heavily-regulated sectors of the economy simply have no cognizable property rights that are constitutionally protected. The South Carolina Supreme Court held that, even though the State's actions were illegal, and, despite a trial court ruling that the property owners had legitimate, investment-backed expectations, as understood under the first prong of this Court's traditional takings analysis in *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104 (1978), *see* App. 5a-9a, they were nonetheless barred from asserting a takings claim because their business activities implicated a type of gaming which had a long history of regulation in South Carolina. Indeed, the decision below held that courts can simply side-step the "essentially ad hoc factual inquiry" of the *Penn Central* analysis, *see* 438 U.S.

at 124, by deciding the supposedly anterior question of whether the property owner had any cognizable and protectable interests at all. *See* App. 6a.

The court below found support for its preemption of the *Penn Central* test in certain decisions from the Court of Federal Claims and the U.S. Court of Appeals for the Federal Circuit. *See* App. 6a-8a (discussing *Maritrans, Inc. v. United States*, 40 Fed. Cl. 790 (1998); *M&J Coal Co. v. United States*, 47 F.3d 1148, 1153-54 (Fed. Cir.), *cert. denied*, 516 U.S. 808 (1995)). But a careful review of these decisions indicates that there is divided authority as to whether courts are at liberty to forego the *Penn Central* analysis in favor of a ruling that the claimant has no cognizable property rights. The first federal court of appeals to enunciate this potential end-run around *Penn Central* was the *M&J Coal* decision. 47 F.3d 1148 (Fed. Cir. 1995). That court observed:

> Thus, we agree with the Court of Federal Claims that precedent indicates a "two-tiered" approach in analyzing a takings claim involving governmental action that results in land use restriction. First, a court should inquire into the nature of the land owner's estate to determine whether the use interest proscribed by the governmental action was part of the owner's title to begin with, i.e., whether the land use interest was a "stick in the bundle of property rights" acquired by the owner. *Lucas*, 505 U.S. at __, 112 S. Ct. at 2899.

Id. at 1153-54. This "two-tier" approach, with the first step offering the prospect of avoiding the *Penn Central* methodology, has been adopted by other courts. *See, e.g., Bay View, Inc. v. United States*, 2001 WL 1530579, *3 (Fed. Cir. Dec. 3, 2001); *Woodland Manor III Associates, L.P. v. McLeod*, 2000 WL 276820, *5 (R.I. Super. Mar 2, 2000).

It is possible that this Court may have unintentionally encouraged this development by its discussion in *Lucas* concerning background principles of property. *See* 505 U.S. at 1027. But this consideration was done solely as a check on an overweening nuisance "exception" in total takings cases, and certainly was not intended to have any application in cases brought under the *Penn Central* test. More recently, this Court has observed that, in the normal course, attempting to divorce the question of cognizable property interests from the larger scope of the *Penn Central* factors, may be unwise. *See Phillips v. Washington Legal Foundation*, 524 U.S. 156, 164 n.4 (noting that ruling on the limited issue of cognizable property rights in IOLTA accounts was necessitated by the posture of the case and limited scope of the Petition's question presented), 173 (Souter, J., dissenting) (objecting to the bifurcation of issues) (1998). Petitioners are mindful that, in certain situations, it may be required for a court to analytically split the question of a claimant's cognizable property interests from the wider context of the impact of regulation on those rights, the claimant's investment-backed expectations, and the character of the governmental action. But the South Carolina Supreme Court's decision purports to allow this deflection from the *Penn Central* analysis in most, if not all, circumstances.

Petitioners would submit that if *Penn Central*'s exquisitely-wrought balancing test were to be so easily circumvented, it would represent a substantial diminution in property protections. Although the *Penn Central* factors have rightly been characterized as being gracious in their tendency to validate government regulation of property, they do at least provide a rigorous approach to examining relevant property interests and attendant forms of regulation. *See Palazzolo v. Rhode Island*, 121 S. Ct. 2448, 2465 (2001) ("Our polestar instead remains the principles set forth in *Penn Central* itself and our other cases that govern partial regulatory takings.

Under these cases, interference with investment-backed expectations is one of a number of factors that a court must examine. Further, the regulatory regime in place at the time the claimant acquires the property at issue helps to shape the reasonableness of those expectations."). Government regulators would, moreover, have not one, but two, opportunities to defeat any takings claim: first by disparaging the property rights as not cognizable, and, second, by prevailing in the *Penn Central* balancing. Distorting the structure of takings analysis in the manner promoted by the South Carolina Supreme Court represents a major departure from established approaches in this area of law.

2. The South Carolina Supreme Court's adoption — as with so many other courts — of a two-tiered approach in regulatory takings cases would be unobjectionable if it were not also accompanied by a categorical exclusion for businesses claiming property rights arising from highly-regulated industries. And while the court below made obliging noises that no such categorical rule was being proffered, *see* App. 8a ("We agree with appellants that a plaintiff who operates in an heavily regulated industry is not prohibited from establishing the existence of a property interest protected by the Fifth Amendment."), the actual effect of the decision is to achieve precisely such a result. The crux of the matter is the South Carolina Supreme Court's reliance on the distinction "whether the property interest affected is inherent in the plaintiff's ownership rights or completely dependent upon regulatory licensing." App. 8a. Under this scheme, if a property interest "inheres" in a property's title, then it will be deemed cognizable. But if it is "dependent upon regulatory licensing," it will be found wanting and the takings claim will be still-born. Courts have badly fractured on the contours of this distinction, rendering it all but useless, save as a license for broader, uncompensated government regulations of property.

a. At the outset, it must be indicated that this Court's statements on the subject have not been entirely consistent. For example, it appears unquestioned that property rights dependent on an Act of Congress are subject to later amendments of the relevant statutory scheme, *see Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 55 (1986); *Democratic Cent. Comm. of D.C. v. Washington Metro. Area Transit Comm'n*, 38 F.3d 603, 606-07 (D.C. Cir. 1994); although the necessity of an express legislative reservation of the capacity to alter otherwise vested property rights has been disputed. *See* in *Fleming v. Rhodes*, 331 U.S. 100, 107 (1947) ("Federal regulation of future action based upon rights previously acquired by the person regulated is not prohibited by the Constitution. So long as the Constitution authorizes the subsequently enacted legislation, the fact that its provisions limit or interfere with previously acquired rights does not condemn it. Immunity from federal regulation is not gained through forehanded contracts."); *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15-16 (1976); *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 226-27 (1986).

This string of authority was recently incorporated into a takings context by this Court's decision in *Concrete Pipe & Prods. of Cal., Inc. v. Construction Laborers Pension Trust for So. Cal.*, 508 U.S. 602 (1993), where it was observed:

> The final factor is the degree of interference with Concrete Pipe's "reasonable investment-backed expectations." 475 U.S., at 226. Again, *Connolly* controls. At the time Concrete Pipe purchased Cen-Vi-Ro and began its contributions to the Plan, pension plans had long been subject to federal regulation, and " '[t]hose who do business in the regulated field cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end.' *FHA v. The Darlington*, Inc.,

> 358 U.S. 84, 91 (1958). *See also Usery v. Turner Elkhorn Mining Co.*, 428 U.S., at 15-16, and cases cited therein." Id., 475 U.S., at 227.

Id. at 645-46.

It appears that to the extent this Court regards the "heavily-regulated" nature of an activity to be relevant at all, it is to be considered only as part of the "legitimate investment-backed expectations" prong of the *Penn Central* test. *See Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1005 (1984). A number of lower courts have taken this position, and have relied on this Court's precedents to resist the temptation to forego the *Penn Central* analysis in favor of making a snap judgment concerning cognizable property rights. *See Golden Pacific Bancorp v. United States*, 15 F.3d 1066, 1072-73 (Fed. Cir.), *cert. denied*, 513 U.S. 961 (1994); *Maritrans v. United States*, 40 Fed. Cl. 790, 797 (1998) ("*Connolly* and *Concrete Pipe* do not support the Government's theory that the regulated nature of the industry precludes a cognizable Fifth Amendment property interest; *i.e.*, that plaintiffs' claim should fail at the first tier of the inquiry mentioned by *M & J Coal*. The Supreme Court could have established such a rule. Instead, the Court in both cases analyzed the three familiar *Penn Central* factors, including an evaluation of the reasonableness of the plaintiffs' investment-backed expectations. These cases do not establish a blanket rule, even with respect to distinct investment-backed expectations."); *State v. The Mill*, 887 P.2d 993, 1000 (Colo. 1994), *cert. denied*, 515 U.S. 1159 (1995). These decisions are certainly at odds with those courts (including the South Carolina Supreme Court) which have divorced the cognizability inquiry entirely from the application of the *Penn Central* factors.

b. In any event, no decision of this Court has ever sanctioned a sweeping "heavily-regulated industry" exception to cognizable property rights in takings claims. Nevertheless, lower courts have divided on precisely whether such an exception exists, and, if it does, what its limitations are. The locus classicus of this development appears to be the Federal Circuit's 1988 decision in *Allied-General Nuclear Servs. v. United States*, 839 F.2d 1572 (Fed. Cir.), *cert. denied*, 488 U.S. 819 (1988), where that court held that a nuclear operator's expectation of being awarded a license to recycle spent nuclear fuel was not protected under the Fifth Amendment. *See id.* at 1576-77. Analogizing nuclear operations to nuisances, the Federal Circuit was obliged to rely on *Mugler v. Kansas*, 123 U.S. 623 (1887); and *Hadacheck v. Sebastian*, 239 U.S. 394 (1915), precedents that were later called into question by this Court's ruling in *Lucas*, 505 U.S. at 1023, 1026 n.13. The Federal Circuit also noted that the operator had essentially acquiesced in the regulatory scheme which subsequently terminated their property rights. *See id.* at 1577 ("Appellants do not deny they accepted the regulatory scheme so far as it might have resulted in denial of construction or operating licenses on the ground the plant, as appellants would operate it, was unsafe.")

As a consequence of the unsteady premises of the "heavily-regulated industry" doctrine in *Allied-General*, it was perhaps no surprise that it was explicitly rejected, or was vastly circumscribed, in other cases. For example, in *United Nuclear Corp. v. United States*, 912 F.2d 1432 (Fed. Cir. 1990), the Federal Circuit rejected the government's suggestion that the landowner was on notice that subsequent regulation could render his interest unprotectable under the Takings Clause. *See id.* at 1436 ("The fact that United agreed that the leases would be subject to future regulations does not indicate that United fairly can be said to have anticipated

that the Secretary would apply a new policy requiring tribal approval of mining plans to leases entered into almost six years earlier, in reliance on which United had expended some $5 million."). The *United Nuclear* court limited *Allied-General* to its unique context of presidential controls and the prevention of nuclear proliferation. *See id.* at 1437-38.

Despite these adverse opinions, new life was breathed into the "heavily-regulated industries" exception by the Federal Circuit's ruling in *Mitchell Arms, Inc. v. United States*, 7 F.3d 212 (Fed. Cir. 1993), *cert. denied*, 511 U.S. 1106 (1994); which held that arm's manufacturers import licenses were not a property right protected under the Fifth Amendment. Relying on the *Allied-General* decision and this Court's ruling in *Bowen*, 477 U.S. 41, the Federal Circuit concluded that

> Mitchell's expectation of selling the assault rifles in domestic commerce — the interest affected in this case — was not inherent in its ownership of the rifles. Rather, it was totally dependent upon the import permits issued by ATF. In short, Mitchell's ability to import the rifles and sell them in the United States was at all times entirely subject to the exercise of ATF's regulatory power. Consequently, any expectation which arose on Mitchell's part as a result of the import permits did not constitute a property right protected by the Fifth Amendment.

7 F.3d at 217. It was precisely this logic — of distinguishing inherent property interests from those bestowed by regulatory favor — which was extended by the South Carolina Supreme Court in the decision below. That court went on even to conclude that no cognizable property interest exists in contracts concerning a "heavily regulated" subject, irrespective of whether the relevant State action was legal or illegal. *See* App. 8a-9a.

c. From this quite questionable set of precedents, a categorical exception for highly-regulated industries has emerged as a favored means for courts to circumvent traditional takings analysis. The doctrine has been applied in such various contexts as to refuse recognition to property rights (1) acquired through international commerce; *see Abrahim-Youri v. United States*, 139 F.3d 1462, 1468 (Fed. Cir. 1997) ("Certain sticks in the bundle of rights that are property are subject to constraint by government, as part of the bargain through which the citizen otherwise has the benefit of government enforcement of property rights."), *cert. denied*, 524 U.S. 951 (1988); *Chang v. United States*, 859 F.2d 893, 898 (Fed. Cir. 1988); (2) concerning the use of land contaminated with uranium tailings; *see State v. The Mill*, 887 P.2d 993, 1000 (Colo. 1994); (3) arising from fishing operations, *see Conti v. United States*, 48 Fed. Cl. 532 (2001); or (4) from grazing permits. *See Alves v. United States*, 133 F.3d 1454, 1457 (Fed. Cir. 1998); *Hage v. United States*, 35 Fed. Cl. 147, 171 (1996).

Some courts have, however, sounded strong cautionary alarms at the practice of simply declaring a property interest to be non-cognizable simply because it involves economic activities in heavily-regulated sectors or depends upon regulatory licensing. The Court of Federal Claims considered this question in *Maritrans, Inc. v. United States*, 40 Fed. Cl. 790 (1998), in a discussion that is worth quoting at length:

> These cases [*Allied-General*, *United Nuclear*, and *Mitchell Arms*] may explain why the property rights asserted were dependent upon the regulatory power of the Government; but they do not establish that plaintiffs' property rights, including the right to use its vessels, are not inherent in their ownership. The inquiry is not so simple as examining whether the Government prevents the

> exercise of a property right by regulating it, transforming the property right into one "totally dependent" on the Government's regulatory regime. That is a tautology; the inquiry is considerably more nuanced.
>
> . . . .
>
> Establishing a taking claim in certain spheres of activity may be difficult. But we are not aware of a blanket no-takings rule with respect to regulated industries; or that one may never prevail on a takings claim if participating in a heavily regulated industry. Certainly we cannot accept the Government's argument that because the industry in which Maritrans participates is regulated, we should end the inquiry at the first tier of analysis.

Id. at 796, 797.

Beyond this general split in opinion on the propriety of refusing recognition to certain property rights, courts are further divided on what the essential ingredient is that makes a heavily-regulated property interest uncompensable. Some have suggested that it is whether regulation prevents a party from excluding others, an essential "stick" in the "bundle" of property rights. *See Golden Pacific Bancorp*, 15 F.3d at 1072-73. Others have examined whether the interest is more akin to "a revocable license or privilege." *Conti*, 48 Fed. Cl. at 537. Or, in the more extreme formulation offered below by the South Carolina Supreme Court, the inquiry was whether the property interest was "completely dependent upon the regulatory licensing scheme rather than inherent in their right to own or possess" the property, with the admitted illegality of the State's action being of no moment. App. 8a.

d. In essence, the South Carolina Supreme Court has propounded a standardless and tautological basis for completely short-circuiting any takings inquiry. Merely by characterizing a property interest as dependent upon regulation, a court can simply declare it non-cognizable, dispense with even the (relatively) gracious *Penn Central* balancing, and dismiss the takings action as not even stating a claim upon which relief can be granted. Analytically similar to the nuisance exception which the same court employed in *Lucas v. South Carolina Coastal Council*, 304 S.C. 376, 404 S.E.2d 895 (1991), *rev'd*, 505 U.S. 1003 (1992), a "highly-regulated industry" exception could potentially work the same, dangerous effects on the cohesion of this Court's takings jurisprudence.

Indeed, the validity and propriety of such a categorical exclusion from traditional takings analysis seems to be cast into doubt by this Court's decision in *Palazzolo v. Rhode Island*, which vigorously rejected a sweeping attempt by states to deny property owner's compensation because of supposedly pre-existing regulatory regimes. *See* 121 S. Ct. at 2462

> The theory underlying the argument that post-enactment purchasers cannot challenge a regulation under the Takings Clause seems to run on these lines: Property rights are created by the State. So, the argument goes, by prospective legislation the State can shape and define property rights and reasonable investment-backed expectations, and subsequent owners cannot claim any injury from lost value. After all, they purchased or took title with notice of the limitation. The State may not put so potent a Hobbesian stick into the Lockean bundle.

South Carolina's attempt to disclaim any compensable property interest for video game owners who were in

compliance with established statutory guidelines, *see* App. 4a, based on the conclusion that the operators should have known that more extreme forms of regulation, even rising to the level of illegal confiscation, were imminent, *see* App. 8a-9a, has the potential of diminishing constitutional property protections to the vanishing point. Indeed, the South Carolina Supreme Court's position appears to be that property owners bear the burden of submitting even to types of regulation that are subsequently found to be unconstitutional for lack of uniform effect or application within a state.

In the event that this Court were to grant review, Petitioners would first contend that the South Carolina Supreme Court analytically erred in collapsing the question of the claimants' cognizable property interests, and waiving the necessity of applying the totality of the *Penn Central* factors. But even if this Court were to regard such as appropriate, Petitioners would still submit that the lower court's sweeping generalization that businesses dependent on regulatory licensing can have no compensable property rights is contrary to this Court's rulings. This Court would thus be called upon to fashion a sensible and coherent set of factors that would differentiate those highly-regulated property interests which are unworthy of constitutional protection, from those deserving of the full security that the Fifth Amendment affords. An action by a state that illegally shuts down a highly-regulated industry is still a regulation that "goes too far." This is the basic principle that governs regulatory-taking jurisprudence. *See Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

3. That leaves for consideration the South Carolina Supreme Court's impairment of contracts ruling. *See* App. 9a-12a. In essence, the lower court simply duplicated its takings holding and ruled that participants in highly-regulated sectors should be able to foresee further regulation, and thus

that there was no substantial impairment of a contractual obligation, as required under the first prong of this Court's Contracts Clause jurisprudence. *See United States Trust*, 431 U.S. at 17; *Allied Structural Steel*, 438 U.S. at 244. As it accomplished in the disposition of the property-owners' takings claim, the South Carolina Supreme Court managed to convert the highly-nuanced and contextual Contracts Clause analysis into a simplistic (one might say, even, moralistic) assertion that those who work in regulated industries should not complain when even an unconstitutional change is made which eliminates their property interests.

In recent cases, the U.S. Supreme Court has reiterated that the Contract Clause of the federal Constitution prevents state legislatures from adopting laws that unfairly alter or modify private contracts. In *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978), the Court struck-down a Minnesota statute which effectively increased the monetary obligations of companies which had a pre-existing pension plan for employees and which either terminated the plan or closed their business facility in Minnesota. The Supreme Court found a violation of the Contract Clause in *Spannaus* because of a number of factors, including many which are present in the case presented here. Among these are: (1) the impairment of pre-existing contractual arrangements was found to be "substantial," 438 U.S. at 244-45; *cf. Texaco, Inc. v. Short*, 454 U.S. 516 (1982); (2) the affected businesses had "relied heavily, and reasonably" on its previous contractual arrangements; *Spannaus*, 438 U.S. at 246; *see also El Paso v. Simmons*, 379 U.S. 497, 515 (1965) (Contract Clause protects private contractual parties "to those gains reasonably to be expected from the contract"); (3) the law was not necessary to remedy an "important and general social problem," but, rather, was focused on a limited number of parties; *Spannaus*, 438 U.S. at 250; (4) "the law was not a temporary measure to deal with an emergency situation," *id.*;

and (5) the law regulated a field which the state had not previously sought to regulate, or which it had previously entered, giving rise to justified expectations as to the course of future regulation, *See id.*

As with its inversion of the *Penn Central* factors, the court below fixated on a single inquiry: whether the contractual expectations were eliminated by patterns of past, and the prospect of future, regulation. This Court has indicated that:

> In determining the extent of the impairment, we are to consider whether the industry the complaining party has entered has been regulated in the past. *Allied Structural Steel Co.*, 438 U.S., at 242, n. 13 citing *Veix v. Sixth Ward Bldg. & Loan Ass'n*, 310 U.S. 32, 38 (1940) ("When he purchased into an enterprise already regulated in the particular to which he now objects, he purchased subject to further legislation upon the same topic"). The Court long ago observed: "One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the State by making a contract about them." *Hudson Water Co. v. McCarter*, 209 U.S. 349, 357 (1908).

Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400, 411 (1983). But nowhere has this Court held that the prevalence of pre-existing regulation is the only, much less the decisive, factor for determining a substantial impairment of a contract right under the Contract Clause. Other courts have interpreted the discussion in *Energy Reserves Group* merely as an invitation to consider pre-existing regulation as one factor among many. *See Nieves v. Hess Oil Virgin Islands Corp.*, 819 F.2d 1237, 1243-48 (3d Cir.), *cert. denied*, 484 U.S. 963 (1987); *West End Tenants Assoc. v. George Washington Univ.*, 640 A.2d 718, 733-34

(D.C. 1994). And, indeed, one court has indicated that "From the holdings in *Energy Reserves* and *Allied Structural Steel*, we are instructed that, to preclude a subsequent finding of substantial impairment, earlier regulation must share more with the challenged legislation than simply the identity of the broad industry in which it operates, or even a broad phase of that industry's activity." *Id.* at 734 (discussing *Veix*, 310 U.S. at 38, and whether a party purchased into an enterprise already regulated in the "particular" or "topic" which the party now objects).

While Petitioners acknowledge that their Contracts Clause claim is, to some degree, derivative of their takings challenge, it is significant that the South Carolina Supreme Court has apparently sought to extend its categorical analysis to both sets of constitutional protections of property rights. As part of its methodology, the court below explicitly ruled that it did not matter that the regulation effecting the impairment of contracts was illegal on other grounds. *See* App. 10a. As with its takings ruling, the South Carolina Supreme Court has articulated a principle which insulates the state from the consequences of even its illegal and unconstitutional regulation of property.

If this Court were to decide to grant plenary review in this case, it should consider whether the protections afforded to highly-regulated industries under the Contracts Clause are coterminous with those under the Fifth Amendment, or whether a separate analysis is required. In any event, Petitioners would maintain that where a business has entered into a contract prior to an illegal government action that would have the effect of entirely abrogating that contractual right, it has at least made a *prima facie* case that the impairment has been "substantial." That would, of course, still leave the matter of whether the impairment was properly justified by a significant and legitimate public purpose and

whether the regulation was reasonable and appropriate to achieve that purpose. *See Energy Reserves Group*, 459 U.S. at 411-12. The South Carolina Supreme Court never reached those questions (just as they did not address the three prongs of the *Penn Central* test). This Court need not either, leaving for subsequent proceedings consideration of those required elements of the protections afforded to property-owners by the Takings and Contracts Clauses.

CONCLUSION

For the foregoing reasons, the Petition should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE SUPREME COURT, STATE OF SOUTH CAROLINA DATED NOVEMBER 5, 2001

THE STATE OF SOUTH CAROLINA
In The Supreme Court

Rick's Amusement, Inc., B&B Amusement, Tripp's Amusement Company, Fascination of S.C., Britt's Inc. d/b/a Tripp's Convenience, Crenshaw Technology, Inc., Southern Amusements, Ballard Amusements, Inc., Wilkinson Fuel Company d/b/a Nu-Way Marketing, Greenwood Music Co., Inc., McDonalds Amusements, Inc., Cherokee Trail, Sonoco Amusements, and JSW Amusement, and all those similarly situated,

Plaintiffs,

of whom Rick's Amusements, Inc., B&B Amusement, Tripp's Amusement Company, Fascination of S.C., Britt's Inc. d/b/a Tripp's Convenience, Crenshaw Technology, Inc., Southern Amusements, Ballard Amusements, Inc., Wilkinson Fuel Company d/b/a Nu-Way Marketing, Greenwood Music Co., Inc., McDonalds Amusements, Inc., Cherokee Trail, Sonoco Amusements, and JSW Amusement are Appellants,

v.

State of South Carolina, Respondent.

AND

Leslie Mart, Inc., and all those similarly situated, Plaintiffs,

of whom Leslie Mart, Inc., is Appellant,

Appendix A

v.

State of South Carolina, Respondent.

Appeal From Richland County
Kenneth G. Goode, Circuit Court Judge

Opinion No. 25359

Heard June 6, 2001 – Refiled November 5, 2001

ORDER

PER CURIAM: Appellants filed a Petition for Rehearing. The Court grants the Petition, dispenses with oral argument, and orders Opinion No. 25359, filed September 10, 2001, withdrawn and the following opinion substituted.

IT IS SO ORDERED.

s/ Jean H. Toal, C.J.

s/ James E. Moore, J.

s/ E.C. Burnett, III, J.

Columbia, South Carolina

November 5, 2001

Appendix A

AFFIRMED

A. Camden Lewis and Ariail E. King of Lewis Babcock & Hawkins, L.L.P., and Richard A. Harpootlian of Richard A. Harpootlian, P.A., of Columbia, for appellants.

Ronald K. Wray, II, and Denise L. Bessellieu, of Gallivan, White & Boyd, P.A., of Greenville, and Senior Assistant Attorney General Nathan Kaminiski, Jr., and Assistant Attorney General Christie N. Barrett, of Office of Attorney General, of Columbia, for respondent.

JUSTICE BURNETT: Appellants, owners of video gaming machines and operators of commercial establishments providing video gaming machines, appeal the circuit court's order granting Respondent State of South Carolina's (the State's) Rule 12(b)(6), SCRCP, motion to dismiss. We affirm.

BACKGROUND

In July 1993, the legislature enacted South Carolina Code Ann. § 12-21-2806 (2000) (local option law) which permitted counties to hold a referendum to determine whether non-machine cash payouts for video gaming should become illegal. As a result of the referendum held in November 1994, twelve counties voted in favor of making payouts illegal. Two years later, the local option law was struck down as unconstitutional special legislation. *Martin v. Condon*, 324 S.C. 183, 478 S.E.2d 272 (1996).

Appendix A

Appellants brought these actions against the State to recover losses allegedly incurred by the local option law and the resulting cash payout ban.[1] Appellants claimed they entered into contracts for the placement of video gaming machines prior to enactment of the local option law and that the law illegally "revoked and/or impounded [their] contracts," constituting a taking without just compensation and an unconstitutional impairment of their contracts.[2]

Relying exclusively on *Mibbs, Inc. v. South Carolina Dep't of Revenue*, 337 S.C. 601, 524 S.E.2d 626 (1999), the trial judge determined because future regulations were foreseeable in the highly regulated video poker industry, appellants failed to state a takings claim or contract impairment claim. The trial judge granted the State's Rule 12(b)(6), SCRCP, motion to dismiss.

---

1. Appellants are located in the twelve counties where cash payouts were banned.

2. Appellant Leslie Mart asserted its contract provided for a term beginning on December 6, 1991, with an automatic renewal of another five year term after the first five years. The other appellants asserted they "entered into valid, enforceable contracts . . . prior to the enactment or notice of the provisions of Section 12-21-2806."

Appendix A

ISSUES

I. Did the trial judge err by granting the State's motion to dismiss appellants' takings claim without conducting the three-prong *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104 (1978), test?

II. Did the trial judge err by granting the State's motion to dismiss appellants' impairment of contract claim?

DISCUSSION

I. Takings Claim

Appellants argue the trial judge erred by failing to evaluate their takings claim under the standard three-prong takings analysis rather than simply ruling highly regulated industries are precluded from establishing a takings claim. Appellants rely solely on *Maritrans, Inc. v. United States*, 40 Fed. Cl. 790 (1998). We disagree.

The Takings Clause of the Fifth Amendment to the United States Constitution provides: "[N]or shall private property be taken for public use, without just compensation." Economic regulation may effect a taking. *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998); *see Pennsylvania Coal v. Mahon*, 260 U.S. 393, 415 (1922) (regulation may result in a taking if it goes "too far."). In determining whether governmental regulation violates the Takings Clause, the Court will consider (1) the economic impact of the regulation, (2) its interference with "distinct" investment-backed expectations, and (3) the character of the governmental action. *Penn Central Transp. Co. v. City of New York*, 438

U.S. 104 (1978). More recent cases describe the second factor as the degree of interference with "reasonable" investment-backed expectations. *Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California*, 508 U.S. 602 (1993); *Westside Quik Shop, Inc. v. Stewart*, 341 S.C. 297, 534 S.E.2d 270, *cert. denied* __ U.S.__, 121 S.Ct. 606, 148 L.Ed.2d 518 (2000).

In *Maritrans, Inc. v. United States*, *supra*, the plaintiffs claimed the federal Oil Pollution Act of 1990 "took" their tankers by requiring them to be retrofitted with double hulls to continue operation or to be phased out of service. The government argued the plaintiffs did not have a property interest for purposes of the Fifth Amendment because the shipping industry is heavily regulated and, because plaintiffs could have anticipated the requirement of double hulls, they had no reasonable investment-backed expectations.

The Federal Claims Court explained the Federal Circuit has adopted a two-tier analysis for takings claims. Initially, the Court "must determine whether the proscribed activity is a 'stick' in the plaintiff's bundle of property rights." *Id.* at 793 *citing M&J Coal Co. v. United States*, 47 F.3d 1148, 1153-54 (Fed. Cir. 1995). If the Court finds affirmatively, it then considers the three factors set forth in *Penn Central*.

The *Maritrans* Court discussed *Mitchell Arms, Inc. v. United States*, 7 F.3d 212 (Fed. Cir. 1993),[3] which involved the federal government's revocation of import permits for certain assault weapons after the plaintiff had signed contracts

3. The Court relied in part on *Mitchell Arms* in *Mibbs, Inc. v. South Carolina Dep't of Revenue, supra*.

with a foreign government to purchase the weapons for resale in this country. The plaintiff claimed its investment-backed reliance on the permits constituted a compensable property interest under the Fifth Amendment. The federal circuit disagreed.

The *Maritrans* Court noted *Mitchell Arms'* analysis concerned whether the interest affected was "totally dependent" upon the government's regulatory power or "inherent" in the plaintiff's ownership rights. *Mitchell Arms* found the "expectation of selling the assault rifles in domestic commerce – the interest affected in this case – was not inherent in its ownership of the rifles. Rather, it was totally dependent upon the import permits issued by the ATF." *Maritrans, supra* at 795, citing *Mitchell Arms, supra* at 217. Accordingly, the *Maritrans* Court concluded the heavily regulated nature of an industry does not preclude a cognizable Fifth Amendment property interest. It stated:

> We cannot find support for the proposition that the mere presence of regulation precludes analysis of the three familiar Penn Central factors at the second tier of analysis mentioned by *M & J Coal*.
>
> Establishing a taking claim in certain spheres of activity may be difficult. But we are not aware of a blanket no-takings rule with respect to regulated industries; or that one may never prevail on a takings claim if participating in a heavily regulated industry. Certainly we cannot accept the Government's argument that because the industry in which Maritrans participates is regulated, we

> should end the inquiry at the first tier of analysis. The Government's argument in this respect is without merit.

Maritrans, Inc. v. United States, supra, at 797.

Ultimately, the *Maritrans* Court determined that, although the shipping industry is heavily regulated, the plaintiff's right to ownership of its vessels existed independently of the government's regulatory scheme. Accordingly, Maritrans had a property interest in its tankers which could be compensable under the Fifth Amendment.

We agree with appellants that a plaintiff who operates in an heavily regulated industry is not prohibited from establishing the existence of a property interest protected by the Fifth Amendment. The threshold inquiry is whether the property interest affected is inherent in the plaintiff's ownership rights or completely dependent upon regulatory licensing. *Mibbs, Inc. v. South Carolina Dep't of Revenue, supra*; see also *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1030 (1992), citing *Board of Regents of State Colleges v. Roth*, 408 U.S. 564, 577 (1972) (the range of interests protected by the Fifth Amendment is defined by "existing rules or understandings that stem from an independent source such as state law."). If the property interest is inherent in the plaintiff's ownership rights, then the Court determines whether a compensatory taking has occurred.

Here, appellants claim the invalid local option law "revoked and/or impounded [their] contracts" for the

placement of video gaming machines, thereby constituting a taking. We disagree.

The local option law did not "revoke or impound" appellants' contracts which they entered on the assumption cash payouts would continue to be legal. Appellants' rights to continued cash payouts were completely dependent upon regulatory licensing rather than inherent in appellants' right to own or possess video gaming machines. *Mibbs, Inc. v. South Carolina Dep't of Revenue, supra.* Moreover, their rights to operate video gaming machines were completely dependent upon the regulatory licensing scheme rather than inherent in their right to own or possess the machines. See § 12-21-28-8(7) (Supp. 1995) (recognizing licensing required for operation of coin-operated devices). Appellants' interest in the contracts did not constitute a property interest which could be compensable as a taking. Accordingly, the trial judge did not err by failing to reach the *Penn Central* factors.

II. Impairment of Contract Claim

Appellants assert the trial judge erred by dismissing their Contract Clause claim. They claim that, in spite of the high degree of regulation of the video poker industry, they could not have foreseen an illegal ban on cash payouts. Further, appellants argue that, unlike the video poker operator in *Mibbs, supra*, they entered into contracts before the enactment or notice provisions of the local option law.

Both the United States and South Carolina Constitutions prohibit the State from passing laws which impair the

obligations of contracts. See U.S. Const. art. I, § 10; S.C. Const. art. I, § 4. A three-step analysis is applied to determine whether a law violates the federal and state Contract Clauses. *Ken Moorhead Oil Co. v. Federated Mutual Ins. Co.*, 323 S.C. 532, 476 S.E.2d 481 (1996). Initially, the Court must determine whether the state law has operated as a substantial impairment of a contractual relationship. If the regulation does constitute a substantial impairment, the State, in justification, must have a significant and legitimate public purpose behind the regulation. Lastly, once a legitimate public purpose has been identified, the Court determines whether the adjustment of contractual rights is based upon reasonable conditions and is of a character appropriate to the public purpose. *Mibbs v. South Carolina Dep't of Revenue, supra.*

In *Mibbs*, the Court addressed this same Contract Clause issue – whether a video poker operator could foresee the passage of the invalid local option law. We held where there is a Contract Clause claim, the threshold inquiry is whether the State law has operated as a substantial impairment of the reasonable expectations of the parties. *Id.* The validity of the regulation is irrelevant to this initial determination. *Id.*

Further, the *Mibbs* Court noted *Martin v. Condon, supra*, struck down the ban on cash payouts because it did not apply statewide, not because the ban was substantively invalid. *Id.* Presumably, the legislature could have banned cash payouts for coin-operated video gaming machines if it did so on a statewide basis.[4]

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4. At oral argument, appellants conceded the legislature could have banned video gaming altogether.

Finally, the fact that appellants entered into contracts for the placement of video gaming machines before the legislature enacted the local option law is an insignificant distinction from *Mibbs*. In *Mibbs*, the Court acknowledged there is "no substantial impairment of a contract where the subject of the contract is a highly regulated business whose history makes further regulation foreseeable." *Id.* S.C. at 608, S.E.2d at 629. It concluded the video poker industry was highly regulated and, therefore, further regulation regarding cash payouts was foreseeable. Although recognizing the operator had entered into contracts after enactment of the local option law, *Mibbs* was nonetheless decided on the basis of the high degree of regulation in the video gaming industry.

Appellants assert our decision today will affect the reliability of contracts entered into by participants in other highly regulated fields like banking and insurance. We disagree. Throughout the late 1980s and early 1990s, the same time period during which appellants entered into their contracts, lawmakers repeatedly introduced legislation specifically aimed at eliminating nonmachine cash payouts.[5] In this unique environment, appellants could not have reasonably expected that no regulation would interfere with their anticipated cash payouts. Our ruling does not affect the certainty of contracts in highly regulated fields.

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5. *See, e.g*, H.R.3823, 108th Leg., 2d Sess. (1989) (bill to repeal S.C. Code Ann. § 16-19-60; H.R. 2867, 108th Leg., 2d Sess. (1989) (bill to make it unlawful to have or to operate a machine for playing games which utilizes a deck of cards); H.R.3104, 109th Leg. 1st Sess. (1991) (bill to repeal § 16-19-60).

Appendix A

As previously determined in *Mibbs*, the trial judge properly dismissed the impairment of contract claim because appellants could not have reasonably expected cash payouts for coin-operated video gaming machines to remain legal when they entered into the contracts.

AFFIRMED.

TOAL, C.J., MOORE, J., and Acting Justices C. Victor Pyle, Jr., and Thomas L. Hughston, Jr., concur.

APPENDIX B — ORDER OF DISMISSAL OF THE STATE OF SOUTH CAROLINA IN THE COURT OF COMMON PLEAS, COUNTY OF RICHLAND DATED MAY 9, 2000

STATE OF SOUTH CAROLINA
IN THE COURT OF COMMON PLEAS
COUNTY OF RICHLAND

C/A No. 99-CP-40-4530

Rick's Amusements, Inc. B&B Amusement, Tripps's Amusement Company, Fascination of S.C., Britt's Inc. d/b/a/ Tripp's Convenience, Crenshaw Technology Inc., Southern Amusements, Ballard Amusements, Inc., Wilkinson Fuel Company d/b/a Nu-Way Marketing, Greenwood Music Co., Inc., McDonalds Amusements, Inc. Cherokee Tail, Sonoco Amusements, and JSW Amusement, and all those similarly situated,

Plaintiffs,

vs.

State of South Carolina,

Defendant.

Appendix B

C/A No. 99-CP-40-4503

Leslie Mart, Inc. and all those similarly situated,

Plaintiff,

vs.

State of South Carolina,

Defendant.[1]

ORDER OF DISMISSAL

This case is before the court on Defendant's Motion for Dismissal pursuant to Rule 12(b)(6) of the South Carolina Rules of Civil Procedure. It is a follow up case to *Mibbs v. Department of Revenue*, __ S.C. __, 524 S.E.2d 626 (1999), where Plaintiff has tried to correct the infirmities of that Plaintiff as pointed out by the Supreme Court. This action was brought by Plaintiffs seeking to recover damages allegedly sustained when the registered electors of 12 counties voted, pursuant to a statewide referendum authorized by South Carolina Code Anno. § 12-21-2806, to ban cash payouts from coin-operated video game machines. Plaintiffs contended that as a result of the State's actions, the contracts they entered into with respect to the video game machines were interfered with and so substantially impaired that they were rendered impossible to fill, and that the State's actions constituted a taking. For the reasons set forth below, I find that Defendant's Motion to Dismiss should be granted.

1. These two cases were consolidated because of the similarity of issues. The analysis here, which relates to Leslie Mart v. State of South Carolina, applies to the consolidated case as well, and this order applies to both cases.

Appendix B

Defendant argues that Plaintiff does not have compensable property interest under *Mibbs*. In *Mibbs*, the Court held that in determining whether a government regulation violates the takings clause, the court should consider the "reasonable investment backed expectations" of the party. *Id.* at 628. The Court concluded that the plaintiff there had no "investment-backed expectation since Mibbs invested nothing in obtaining or performing these contracts." *Id.* at 628. Here, Plaintiff entered into the contracts prior to the enactment or notice of the provisions of S.C. Code Anno. § 12-21-2806. Furthermore, the Plaintiff has alleged an investment-backed expectation, stating that he made "modifications to his convenience store, invested in equipment and spend thousands of dollars in performing and procuring the contract." Complaint ¶ 15. He alleges that he "redesigned the business and invested large amounts of money into the business in an effort to obtain and perform the contract." Complaint ¶ 19. I find that Plaintiff has alleged sufficient facts to support a claim of an investment-backed expectation, and thus, he did have a compensable property interest sufficient to support a takings action. Defendant's Motion to Dismiss on this ground is denied.

Defendants also claim that Plaintiff has not alleged damages recoverable under a taking pursuant to *Mibbs*. In that case the Supreme Court held that "[c]ollateral damages, including lost business profits, are not recoverable on a takings claims." *Id.* at 628. Here the Plaintiff is not seeking loss of profits, but instead is requesting "to be paid the value of the interest taken" (Complaint ¶55), or, simply put, the value of the contract itself. I find that Plaintiff has alleged damages recoverable under a taking and that

Defendant's Motion to Dismiss on this ground must be denied.

Next, Defendant argues that Plaintiff has failed to state an action for taking or an impairment of contracts because a interest depending upon regulatory licensing is not compensable. I agree. The Supreme Court held that there can be no taking where the subject is a highly regulated area because history makes future regulations foreseeable. *Mibbs* at 628, 629. The Court went on to say that it does not matter that the regulations are unconstitutional and invalid. *Id.* at 629. Plaintiffs cannot overcome this hurdle. There is little question that the unconstitutional act providing for the referendum made the contracts in question impossible to perform and, in effect, voided them, but there can be no taking or impairment because video poker is a highly regulated area. Therefore, I hold that Plaintiff's action must be dismissed on these grounds.

I find three of Defendant's alternate arguments for dismissal – sovereign immunity, legislative immunity, and the South Carolina Tort Claims Act–to be groundless. This case is an action under the takings clause, South Carolina Constitution, Article I, § 4. A government is subject to lawsuits under these sections, and is not protected by immunity. *See, Chesterfield County v. State Highway Dep't*, 181 S.C. 323, 187 S.E. 548 (1936) (Section 13 is self-acting and gives the party injured the right to sue the agency of the State involved); *Alston v. City of Camden*, 322 S.C. 38, 471 S.E.2d 174 (1996) (Action by city employee against city alleging that ordinances impaired their employment contracts).

Further, I find that the statute of limitations does not serve as a bar to Plaintiff's claim. The applicable statute of limitations is three years, and the statute begins to run from the date the Plaintiff knew that the Defendant's conduct gave rise to a cause of action. S.C. Code Anno. §§ 15-3-530(5) and 15-3-535 (Supp. 1999). The Supreme Court ruled that the State's actions regarding the referendum were unconstitutional on November 4, 1996 in *Martin v. Condon*, 324 S.C. 183, 478 S.E.2d 272 (1996). However, a rehearing was requested, and that request for rehearing was not denied until December 9, 1996. Thus, it is at least a jury question as to the date Plaintiff could have had knowledge that Defendant's conduct was illegal and unconstitutional. This action was filed on December 8, 1999 – within three years from the rehearing denial.

Finally, I find that Defendant's remaining grounds for dismissal should be denied. Defendant argues that to the extent that Plaintiff seeks damages from any alleged violations of the federal Constitution, that the state is not a "person" that can be sued for damages. I find this argument completely inapplicable; this argument applies in the context of a claim under 42 U.S.C. § 1983, as Defendant itself admits in its Brief in Support of the motion. Plaintiff has no such cause of action in the Complaint. Therefore, whether or not the state constitutes a "person" is not a question properly before the court.

Likewise, Defendant's argument that Plaintiff's case must be dismissed because Plaintiff cannot recover money damages from the enforcement of a law later declared unconstitutional fails in this case. While South Carolina has

no case law in this area, many other states do not permit damages in actions based on unconstitutional legislation. *See e.g. Brown v. New York*, 89 N.Y.2d 172 (Ct. App. 1996); *Ashton v. Brown*, 660 A.2d 447 (Md. 1995); *Ostendorfer v. Turner*, 426 So.2d 539 (Fla. 1982). In *Ashton v. Brown, supra*, the plaintiffs were detained by the municipality pursuant to a curfew that was later struck down as unconstitutional. The court held that the plaintiffs were allowed to seek damages against the municipality for injuries caused by officials of the municipality while enforcing a law that was presumptively valid. *Id.* Here, Plaintiff has alleged a cause of action for damages for a taking or impairment of contract, which occurred pursuant to an unconstitutional statute. By Defendant's own admission, this appears to be a novel issue in South Carolina. South Carolina law is clear that where a novel theory is put forward, the granting of a demurrer (which is the predecessor to Rule 12(b)(6) is generally inappropriate and should be denied. *See, e.g., Springfield v. Williams Plumbing Supply Co.*, 249 S.C. 130, 153 S.E.2d 184 (1967); *Revis v. Martin*, 260 S.C. 347, 195 S.E.2d 715 (1973); and, *Vaden v. College Heights Subdivision*, 261 S.C. 509, 201 S.E.2d 113 (1973). Our Supreme Court has continued to follow this rule on a 12(b)(6) motion to dismiss. *See, Garner v. Morrison Knudsen Corp.*, 456 S.E.2d 907, 909-910 (1995). Thus, Defendant's motion to dismiss on this ground is denied.

Appendix B

In conclusion, I find that Plaintiff has failed to allege facts sufficient to constitute a cause of action under the takings clause or for impairment of contracts because the interests that are the subject of the contract are in a highly regulated area, which makes further regulations foreseeable. Thus, I find that this case shall be dismissed on those grounds alone, and all other grounds for dismissal shall be denied as set forth hereinabove.

IT IS SO ORDERED this 9 day of May, 2000.

/s/
Kenneth G. Goode
Presiding Judge, Fifth Judicial Circuit

Winnsboro, South Carolina

APPENDIX C — ORDER OF DISMISSAL OF THE COURT OF COMMON PLEAS, STATE OF SOUTH CAROLINA, COUNTY OF RICHLAND DATED MAY 9, 2000 AND FILED MAY 12, 2000

IN THE COURT OF COMMON PLEAS
STATE OF SOUTH CAROLINA
COUNTY OF RICHLAND

C/A No. 99-CP-40-4530

Rick's Amusements, Inc. B&B Amusement, Tripps's Amusement Company, Fascination of S.C., Britt's Inc. d/b/a/ Tripp's Convenience, Crenshaw Technology Inc., Southern Amusements, Ballard Amusements, Inc., Wilkinson Fuel Company d/b/a Nu-Way Marketing, Greenwood Music Co., Inc., McDonalds Amusements, Inc. Cherokee Tail, Sonoco Amusements, and JSW Amusement, and all those similarly situated,

Plaintiffs,

vs.

State of South Carolina,

Defendant.

Appendix C

C/A No. 99-CP-40-4503

Leslie Mart, Inc. and all those similarly situated,

Plaintiff,

vs.

State of South Carolina,

Defendant.[1]

This case is before the court on Defendant's Motion for Dismissal pursuant to Rule 12(b)(6) of the South Carolina Rules of Civil Procedure. It is a follow up case to *Mibbs v. Department of Revenue*, __ S.C. __, 524 S.E.2d 626 (1999), where Plaintiff has tried to correct the infirmities of that Plaintiff as pointed out by the Supreme Court. This action was brought by Plaintiffs seeking to recover damages allegedly sustained when the registered electors of 12 counties voted, pursuant to a statewide referendum authorized by South Carolina Code Anno. § 12-21-2806, to ban cash payouts from coin-operated video game machines. Plaintiffs contended that as a result of the State's actions, the contracts they entered into with respect to the video game machines were interfered with and so substantially impaired that they were rendered impossible to fill, and that the State's actions constituted a taking. For the reasons set forth below, I find that Defendant's Motion to Dismiss should be granted.

1. These two cases were consolidated because of the similarity of issues. The analysis here, which relates to Leslie Mart v. State of South Carolina, applies to the consolidated case as well, and this order applies to both cases.

Appendix C

This case is before the court on Defendant's Motion for Dismissal pursuant to Rule 12(b)(6) of the South Carolina Rules of Civil Procedure. It is a follow up case to *Mibbs v. Department of Revenue*, __ S.C. __, 524 S.E.2d 626 (1999), where Plaintiff has tried to correct the infirmities of that Plaintiff as pointed out by the Supreme Court. This action was brought by Plaintiffs seeking to recover damages allegedly sustained when the registered electors of 12 counties voted, purusant to a state-wide referendum authorized by South Carolina Code Anno. § 12-21-2806, to ban cash payments from coin-operated video game machines. Plaintiffs contended that as a result of the State's actions, the contracts they entered into with respect to the video game machines were interfered with and so substantially impaired that they were rendered impossible to fill, and that the State's actions constituted a taking. For the reasons set forth below, I find that Defendant's Motion to Dismiss should be granted.

Defendant argues that Plaintiff does not have compensable property interest under *Mibbs*. In *Mibbs*, the Court held that in determining whether a government regulation violates the takings clause, the court should consider the "reasonable investment backed expectations" of the party. *Id.* at 628. The Court concluded that the plaintiff there had no "investment-backed expectation since Mibbs invested nothing in obtaining or performing these contracts." *Id.* at 628. Here, Plaintiff entered into the contracts prior to the enactment or notice of the provisions of S.C. Code Anno. § 12-21-2806. Furthermore, the Plaintiff has alleged an investment-backed expectation, stating that he made "modifications to his convenience store, invested in equipment and spend thousands of dollars in performing and procuring the contract." Complaint ¶ 15. He alleges that he

"redesigned the business and invested large amounts of money into the business in an effort to obtain and perform the contract." Complaint ¶ 19 I find that Plaintiff has alleged sufficient facts to support a claim of an investment-backed expectation, and thus, he did have a compensable property interest sufficient to support a takings action. Defendant's Motion to Dismiss on this ground is denied.

Defendants also claim that Plaintiff has not alleged damages recoverable under a taking pursuant to *Mibbs*. In that case the Supreme Court held that "[c]ollateral damages, including lost business profits, are not recoverable on a takings claims." *Id.* at 628. Here the Plaintiff is not seeking loss of profits, but instead is requesting "to be paid the value of the interest taken" (Complaint ¶ 55), or, simply put, the value of the contract itself. I find that Plaintiff has alleged damages recoverable under a taking and that Defendant's Motion to Dismiss on this ground must be denied.

Next, Defendant argues that Plaintiff has failed to state an action for a taking or an impairment of contracts because a interest depending upon regulatory licensing is not compensable. I agree. The Supreme Court held that there can be no taking where the subject is a highly regulated area because history makes future regulations foreseeable. *Mibbs* at 628, 629. The Court went on to say that it does not matter that the regulations are unconstitutional and invalid. *Id.* at 629. Plaintiffs cannot overcome this hurdle. There is little question that the unconstitutional act providing for the referendum made the contracts in question impossible to perform and, in effect, voided them, but there can be no taking

or impairment because video poker is a highly regulated area. Therefore, I hold that Plaintiff's action must be dismissed on these grounds.

I find three of Defendant's alternate arguments for dismissal — sovereign immunity, legislative immunity, and the South Carolina Tort Claims Act — to be groundless. This case is an action under the takings clause, South Carolina Constitution, Article I, § 13, and impairment of a contract, South Carolina Constitution, Article I, § 4. A government is subject to lawsuits under these sections, and is not protected by immunity. *See, Chesterfield County v. State Highway Dep't*, 181 S.C. 323, 187 S.E. 548 (1936) (Section 13 is self-acting and gives the party injured the right to sue the agency of the State involved); *Alston v. City of Camden*, 322 S.C. 38, 471 S.E.2d 174 (1996) (Action by city employees against city alleging that ordinances impaired their employment contracts).

Further, I find that the statute of limitations does not serve as a bar to Plaintiff's claim. The applicable statute of limitations is three years, and the statute begins to run from the date the Plaintiff knew that the Defendant's conduct gave rise to a cause of action. S.C. Code Anno. §§ 15-3-530(5) and 15-3-535 (Supp. 1999). The Supreme Court ruled that the State's actions regarding the referendum were unconstitutional on November 4, 1996 in *Martin v. Condon*, 324 S.C. 183, 478 S.E.2d 272 (1996). However, a rehearing was requested, and that request for rehearing was not denied until December 9, 1996. Thus, it is at least a jury question as to the date Plaintiff could have had knowledge that Defendant's conduct was illegal and unconstitutional. This action was filed on December 8, 1999 — within three years from the rehearing denial.

Appendix C

Finally, I find that Defendant's remaining grounds for dismissal should be denied. Defendant argues that to the extent that Plaintiff seeks damages from any alleged violations of the federal Constitution, that the state is not a "person" that can be sued for damages. I find this argument completely inapplicable; this argument applies in the context of a claim under 42 U.S.C. § 1983, as Defendant itself admits in its Brief in Support of the motion. Plaintiff has no such cause of action in the Complaint. Therefore, whether or not the state constitutes a "person" is not a question properly before the court.

Likewise, Defendant's argument that Plaintiff's case must be dismissed because Plaintiff cannot recover money damages from the enforcement of a law later declared unconstitutional fails in this case. While South Carolina has no case law in this area, many other states do permit damages in actions based on unconstitutional legislation. See e.g. *Brown v. New York*, 89 N.Y.2d 172 (Ct. App. 1996); *Ashton v. Brown*, 660 A.2d 447 (Md. 1995); *Ostendorfer v. Turner*, 426 So.2d 539 (Fla. 1982). In *Ashton v. Brown*, supra, the plaintiffs were detained by the municipality pursuant to a curfew that was later struck down as unconstitutional. The court held that the plaintiffs were allowed to seek damages against the municipality for injuries caused by officials of the municipality while enforcing a law that was presumptively valid. *Id.* Here, Plaintiff has alleged a cause of action for damages for a taking or impairment of contract, which occurred pursuant to an unconstitutional statute. By Defendant's own admission, this appears to be a novel issue in South Carolina. South Carolina law is clear that where a novel theory is put forward, the granting of a

demurrer (which is the predecessor to Rule 12(b)(6)) is generally inappropriate and should be denied. See, e.g., *Springfield v. Williams Plumbing Supply Co.*, 249 S.C. 130, 153 S.E.2d 184 (1967); *Revis v. Martin*, 260 S.C. 347, 195 S.E.2d 715 (1973); and, *Vaden v. College Heights Subdivision*, 261 S.C. 509, 201 S.E.2d 113 (1973). Our Supreme Court has continued to follow this rule on a 12(b)(6) motion to dismiss. *See*, *Garner v. Morrison Knudsen Corp.*, 456 S.E.2d 907, 909-910 (1995). Thus, Defendant's motion to dismiss on this ground is denied.

In conclusion, I find that Plaintiff has failed to allege facts sufficient to constitute a cause of action under the takings clause or for impairment of contracts because the interests that are the subject of the contract are in a highly regulated area, which makes further regulations foreseeable. Thus, I find that this case shall be dismissed on those grounds alone, and all other grounds for dismissal shall be denied as set forth hereinabove.

IT IS SO ORDERED this 9 day of May 2000.

s/ Kenneth G. Goode
Kenneth G. Goode
Presiding Judge, Fifth Judicial Circuit

Winnsboro, South Carolina

APPENDIX D — ORDER OF THE COURT OF COMMON PLEAS DENYING MOTION TO ALTER OR AMEND DATED JULY 14, 2000 AND FILED JULY 17, 2000

IN THE COURT OF COMMON PLEAS
STATE OF SOUTH CAROLINA
COUNTY OF RICHLAND

C-A-No. 99-CP-40-4530

Rick's Amusements, Inc. B&B Amusement, Tripp's Amusement Company, Fascination of S.C., Inc., Britt's Inc. d/b/a Tripp's Convenience, Crenshaw Technology, Inc., Southern Amusements, Ballard Amusements, Inc., Wilkinson Fuel company d/b/a Nu-Way Marketing, Greenwood Music Co., Inc., McDonalds Amusements, Inc., Cherokee Trial, Sonoco Amusement, and JSW Amusement, and all those similarly situated,

Plaintiffs,

vs.

State of South Carolina,

Defendant.

Appendix D

C-A-No. 99-CP-40-4503

Leslie Mart, Inc., and all those similarly situated,

Plaintiff,

vs.

State of South Carolina,

Defendant.

ORDER

This matter comes before the Court on Defendant's Motion to Alter or Amend.

The Defendant argues via correspondence dated May 16, 2000 that this Court improperly signed the order in that it was not served upon Defendant's counsel in the same manner it was served upon the Court pursuant to Rule 5(b)(3) of the South Carolina Rules of Civil Procedure. Although the rule was not technically followed, the main concern of the Defendant appears to be that its proposed order had not yet been received or reviewed.

This Court received and deliberated over proposed orders from both parties prior to signing the Order dated May 9, 2000. Therefore, this argument is without merit.

This Court also finds that the Defendant's additional arguments contained within the Motion to Alter or Amend are without merit.

Appendix D

THEREFORE, IT IS ORDERED that the Defendant's Motion to Alter or Amend this Court's Order dated May 9, 2000 is DENIED.

s/ Kenneth G. Goode
Kenneth G. Goode
Presiding Judge, Fifth Judicial Circuit

July 14, 2000
Winnsboro, South Carolina

APPENDIX E — RELEVANT CODES

CODE OF LAWS OF SOUTH CAROLINA
1976 ANNOTATED
TITLE 12. TAXATION
CHAPTER 21. STAMP AND BUSINESS LICENSE TAX
ARTICLE 20. VIDEO GAME MACHINES ACT
[REPEALED BY 1999 ACT NO. 125, PART I, § 8, EFFECTIVE JULY 1, 2000]

§ 12-21-2770. [Repealed, effective July 1, 2000] Short title.

This article may be cited as the Video Game Machines Act.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1999 Act No. 125, § 8.

§ 12-21-2772. [Repealed, effective July 1, 2000] Definitions.

As used in this article:

(1) "Associated equipment" means a proprietary device, machine, or part used in the manufacture or maintenance of a video game machine including, but not limited to, integrated circuit chips, printed wired assembly, printed wired boards, printing mechanisms, video display monitors, and metering devices.

(2) "department" means the South Carolina Department of Revenue.

(3) "Distributor" means any person who buys and sells or leases video machines or associated equipment in this

State. A distributor may also own, operate, service, or repair video machines in this State.

(4) "Licensed establishment" means an establishment owned or managed by a person who is licensed pursuant to Article 19 of this chapter for the location of coin-operated nonpayout video machines with a free play feature.

(5) "Machine" means an electronic video games machine that, upon insertion of cash, is available to play or simulate the play of games as authorized by the department utilizing a video display and microprocessors in which the player may receive free games or credits that can be redeemed for cash.

(6) "Manufacturer" means any person that manufactures or assembles and programs machines or associated replacement equipment authorized for sale or use in this State.

(7) "Net machine income" means money put into the machine minus money paid out in cash. "Gross machine income" means the sum of all cash/money put into the machine.

(8) "Machine owner" means any person, other than a distributor, who owns and operates, maintains, repairs, or services one or more machines in licensed establishments. For purposes of this article "owner/operator" is defined the same as "machine owner".

(9) "Contraband device/equipment" or "gray area machine" means any machine not meeting the requirements of Section 12-21-2782 and Section 12-21-2783.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1997 Act No. 155, Part II, § 54D; 1999 Act No. 125, § 8.

Appendix E

§ 12-21-2774. [Repealed, effective July 1, 2000] Mechanical requirements of machines.

Each machine licensed under this chapter:

(1) may not have any means of manipulation that affect the random probabilities of winning a video game;

(2) shall have one or more mechanisms that accept only coins or cash in the form of bills. The mechanisms must be designed to prevent obtaining credits without paying by stringing, slamming, drilling, or other means;

(3) must have one or more metering devices that keep a record of all cash (total coins accepted, total bills accepted, and total credit generated by the coin and bill acceptors) inserted or deposited into the machine, credits played for video games, and credits won by video players and payments of winnings and other information as prescribed by the department;

(4) must be capable of being accessed on demand by telecommunication from a central computer for purposes of polling or reading device activities and for central computer remote shutdown of machine operations.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1997 Act No. 155, Part II, § 54E; 1999 Act No. 125, § 8.

Appendix E

§ 12-21-2776. [Repealed, effective July 1, 2000] Machines to be licensed; cash controls; certain information to be reported to department quarterly.

(A) All machines must be licensed by the department.

(B) Each machine owner, operator, or licensed establishment must establish and implement cash controls and shall report to the department on a quarterly basis the following information for each machine:

(1) name and address of location of the machine;

(2) denomination, whether five cents, twenty-five cents, etc., of game;

(3) the name of the game;

(4) the name of the individual collecting money from the machine or the owner of the machine;

(5) the date of collection;

(6) the date of previous collection;

(7) income number at commencement of reporting period;

(8) income number at the end of the reporting period;

(9) beginning payout number;

(10) ending payout number;

(11) payout to players;

(12) gross profit;

(13) the percentage of net profits divided between owner and location.

This report must be filed with the department by the twentieth of the month following the end of the calendar quarter.

HISTORY: Added by 1993 Act No. 164, Part II, § 19A; 1995 Act No. 145, Part II, § 67D; 1997 Act No. 155, Part II, § 54F; 1999 Act No. 125, § 8.

§ 12-21-2778. [Repealed, effective July 1, 2000] Machines must be licensed before placement or operation in licensed establishment; license to be prominently displayed.

Each machine must be licensed pursuant to Article 19 of this chapter by the department before placement or operation on the premises of a licensed establishment. Each machine must have the license prominently displayed pursuant to Article 19 of this chapter.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1999 Act No. 125, § 8.

Appendix E

§ 12-21-2780. [Repealed, effective July 1, 2000] Seal corresponding to license to be affixed to metering device.

A seal must be affixed to the department approved metering device which corresponds to the license as set forth in Section 12-21-2778.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1999 Act No. 125, § 8.

§ 12-21-2782. [Repealed, effective July 1, 2000] Standards for licensed video game machines.

All video game machines licensed under Section 12-21-2720(A)(3), no later than December 31, 1998, must:

(1) have games that are random and have a minimum payback of at least eighty percent in which the theoretical payout percentage is determined using standard methods of probability theory;

(2) be secure and accountable;

(3) not operate in a misleading or deceptive manner; and

(4) be capable of interfacing with a computerized monitoring system to be selected by the department.

The technical standards established by the department must be designed so as to maximize competition in the market place among manufacturers.

Appendix E

Machines not meeting the standards of this section or regulation of the department may not be licensed. The license of any machine which fails to maintain the standards of this section or regulation of the department must be revoked.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1995 Act No. 145, Part II, § 67G; 1997 Act No. 155, Part II, § 54G; 1999 Act No. 125, § 8.

§ 12-21-2783. [Repealed, effective July 1, 2000] Location controller and modem; requirements.

(A) As part of the central computer monitoring system required under this article, each location operating video game machines must provide a location controller and modem meeting requirements set forth by this section and by the department. Each location controller must be capable of receiving, storing, and transmitting to the department's central computer monitoring system all information received from, and required of, video game machines as set forth in Section 12-21-2782. Each location controller must be capable of supporting at least five video game machines.

This section applies to those location controllers which participate in the system as separate hardware entities, and any "head of string" location controller which meets the specifications of this section.

The cost for purchasing or leasing, as well as the cost of installing, the location controller is the responsibility of the licensed establishment in which the video game machines are located.

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(B) In addition to the above requirement, each location controller must be able to perform the following functions:

(1) communicate with video game machines in an on-line environment;

(2) when authorized parties open video game machine game door, store a log entry of this event;

(3) when authorized parties open video game machine coin or currency door, store a log entry of this event;

(4) authorize video game machine to be taken off-line from the location controller;

(5) disable video game machine and store a log entry under the following circumstances:

(a) unauthorized game door open; and

(b) unauthorized coin door open;

(6) store a log entry if video game machine is off-line from the location controller without prior authorization;

(7) store a log entry if video game machine tampering is detected. Detection of tampering occurs if the signal received from the video game machine is discontinuous or corrupted in such a manner as to constitute more than spurious noise in the system;

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(8) re-enable a video game machine which has been disabled and store a log entry of this event;

(9) log entries which include a unique identification number for each machine and date/time stamp;

(10) have capability for communicating to the central computer system the information which has been gathered from the video game machines and log any entries stored during the period;

(11) have sufficient storage capacity to maintain at least five days of data generated from the maximum playing sessions from the maximum number of associated video game machines linked to the location controller. The data must be stored immediately in a manner that allows on demand, real time access by the central system. Access to data stored in the location controller must be restricted to authorized entry from the central system and other authorized inquiry only access that has been preapproved by the department;

(12) have an internal clock;

(13) be protected from unauthorized interference or tampering by any person or external device or force, such as to corrupt or alter data or corrupt or suspend communication signals or transmitted data from the video game machines or to the central site, and this requirement extends to the location controller as well as its associated communication device, cabling between the controller and the video game machines, and communication device;

(14) be constructed of materials and protected in such a manner as to allow it to operate in suboptimal environments such as nonregulated temperature, dusty, tobacco-smoke filled, and humid conditions;

(15) be capable of validating tickets printed by a video game machine.

HISTORY: 1997 Act No. 155, Part II, § 54H; 1999 Act No. 125, § 8.

§ 12-21-2784. [Repealed, effective July 1, 2000] Manufacturer, distributor, operator, and establishment must be licensed.

Each machine manufacturer, distributor, operator, and licensed establishment must be licensed by the department pursuant to Article 19 of this chapter and this article before a machine or associated equipment is manufactured, distributed, sold, or placed for public use in this State.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1999 Act No. 125, § 8.

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§ 12-21-2786. [Repealed, effective July 1, 2000] Placement of machines subject to Article 19 of this chapter and rules and regulations of department.

The placement of machines in licensed establishments is subject to the provisions of Article 19 of this chapter and the rules and regulations promulgated by the department.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1999 Act No. 125, § 8.

§ 12-21-2788. [Repealed, effective July 1, 2000] Denial or revocation of establishment license for machine placement not meeting requirements of law.

The department shall deny or revoke an establishment license for machine placement that does not meet the requirements of Section 12-21-2786 pursuant to the provisions of Section 12-54-90.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1999 Act No. 125, § 8.

§ 12-21-2790. [Repealed, effective July 1, 2000] Felony to tamper with machine with intent to interfere with proper operation; penalty.

It is unlawful to tamper with a machine with intent to interfere with its proper operation. A person who violates this section is guilty of a felony and, upon conviction, must

be imprisoned not more than one year or fined not more than five thousand dollars, or both.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1999 Act No. 125, § 8.

§ 12-21-2791. [Repealed, effective July 1, 2000] Limit on cash payout for credits earned for free games.

Any location which operates or allows the operation of coin-operated machines pursuant to Section 12-21-2720(A)(3) which provides payouts shall limit the cash payout for credits earned for free games to two thousand five hundred credits a player a location during any twenty-four hour period. The cash value of credits for each free game is limited to five cents.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1997 Act No. 53, § 2; 1999 Act No. 125, § 8.

§ 12-21-2792. [Repealed, effective July 1, 2000] Skimming of proceeds defined; felony; penalties.

Skimming of machine proceeds is the intentional excluding, or the taking of any action in an attempt to exclude anything or its value from the deposit, counting, collection, or computation of revenues from machines. Whoever commits skimming of machine proceeds is guilty of a felony and, upon conviction, must be imprisoned for not less than

one year nor more than ten years, without benefit of probation, parole, or suspension of sentence, and may be fined not more than twenty-five thousand dollars.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1999 Act No. 125, § 8.

§ 12-21-2793. [Repealed, effective July 1, 2000] Proximity to schools, playgrounds, parks, houses of worship regulated; violations; penalties; relocation pursuant to this section; grandfathering.

Any location which operates or allows the operation of coin-operated machines pursuant to Section 12-21-2720(A)(3) which provides payouts authorized pursuant to Section 16-19-60 may not be located within five hundred feet within a county and within three hundred feet in a municipality of a public or private elementary, middle, or secondary school; a public or private kindergarten; a public playground or park; a public vocational or trade school or technical educational center; a public or private college or university; or house of worship. The owner of any location operating in violation of the provisions of this section shall be guilty of a misdemeanor and shall, upon conviction, be fined not less than one hundred dollars and not more than two hundred dollars or imprisoned for not more than sixty days. Each day of operation shall constitute a separate violation.

The penalty imposed by this section shall not be effective until after September 1, 1993. Any location relocating

pursuant to this section may apply to the department for the reissuance of a license without charge.

The provisions of this section do not apply with respect to any location with machines with licenses issued before May 30, 1993.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1999 Act No. 125, § 8.

§ 12-21-2794. [Repealed, effective July 1, 2000] Tampering, other intentional manipulation a felony; penalties.

A person who, with intent to manipulate the outcome, payoff, or operation of a machine by physical tampering or any other means is guilty of a felony and, upon conviction, must be imprisoned not less than one year nor more than five years or fined not more than one thousand dollars, or both.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1999 Act No. 125, § 8.

§ 12-21-2797. [Repealed, effective July 1, 2000] Operation of contraband or gray area machines; civil penalties; seizure and destruction.

(A) A person in possession of, or allowing the operation of, a contraband or gray area machine at any place within the State after December 31, 1998, is subject to a civil penalty

of not more than ten thousand dollars a machine. In addition, the machine may be seized by any law enforcement officer of the State or any of its political subdivisions.

(B) A machine seized under the provisions of this section must be taken before any magistrate of the county in which the machine was seized. The magistrate shall immediately examine the machine and, if he is satisfied that it is a contraband or gray area machine, shall direct that it be destroyed immediately. The magistrate, at his discretion, may order the department to have any laboratory under contract with it to examine the machine to assist in the determination as to whether or not the machine is a contraband or gray area machine.

HISTORY: 1997 Act No. 155, Part II, § 54J; 1999 Act No. 125, § 8.

§ 12-21-2798. [Repealed, effective July 1, 2000] Promulgation of regulations.

The department may promulgate regulations pertaining to the machines and persons licensed by it.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1997 Act No. 155, Part II, § 54K; 1999 Act No. 125, § 8.

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§ 12-21-2802. [Repealed, effective July 1, 2000] Required display of signs citing penalties for violations.

Each machine licensed under this article or Article 19 must have a prominently displayed sign citing the penalties provided by Sections 12-21-2790, 12-21-2792, and 12-21-2794 on the wall above the machine or affixed prominently to the machine. The department shall make these signs available free of charge.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1999 Act No. 125, § 8.

§ 12-21-2804. [Repealed, effective July 1, 2000] Limit on number of machines; no licensing for establishment whose primary gross proceeds is from machines; advertising and special inducements prohibited; minimum age for payout; residency requirements; hours of operation; license revocation and other penalties.

(A) No person shall apply for, receive, maintain, or permit to be used, and the department shall not allow to be maintained, permits or licenses for the operation of more than eight machines authorized under Section 12-21-2720(A)(3) at a single place or premises for the period beginning July 1, 1993, and ending July 1, 1994. After July 1, 1994, the department may not issue nor authorize to be maintained any licenses or permits for more than five machines authorized under Section 12-21-2720(A)(3) at a single place or premises. Any licenses or permits issued for the operation of machines authorized under Section 12-21-

2720(A)(3) during the period of July 1, 1993, and July 1, 1994, for a two-year period shall continue in effect after July 1, 1994, provided that during the period of July 1, 1994, and July 1, 1995, no person shall maintain at a single place or premises more than eight machines authorized under Section 12-21-2720(A)(3). No machine may be licensed or relicensed in any location where the primary and substantial portion of the establishment's gross proceeds is from machines licensed under Section 12-21-2720(A)(3). The department shall revoke the licenses of machines located in an establishment which fails to meet the requirements of this section. No license may be issued for a machine in an establishment in which a license has been revoked for a period of six months from the date of the revocation. The term "gross proceeds" from the machines means the establishment's portion.

(B) No person who maintains a place or premises for the operation of machines licensed under Section 12-21-2720(A)(3) may advertise in any manner for the playing of the machines nor may a person offer or allow to be offered any special inducement to a person for the playing of machines permitted under Section 12-21-2720(A)(3).

(C) No person under twenty-one years of age may receive a payout as a result of the operation of the machines licensed under Section 12-21-2720(A)(3).

(D) No owner, operator, or marketer may be issued a permit by the department for machines pursuant to Section 12-21-2720(A)(3) unless the owner, operator, or marketer has been a resident of the State for two years. The department shall require a statement of residency to be filed with the

department as part of the application process for permits issued under Section 12-21-2720(A)(3) on forms and in a manner the department considers appropriate.

(E) It is unlawful to operate machines licensed under Section 12-21-2720(A)(3) between the hours of midnight Saturday night and six o'clock a.m. Monday morning.

(F) A person violating subsections (A), (B), (D), or (E) of this section is subject to a fine of up to five thousand dollars to be imposed by the department. The department, upon a determination that the violation is wilful, may refer the violation to the Attorney General or to the appropriate circuit solicitor for criminal prosecution, and, upon conviction, the person must be fined not more than ten thousand dollars or imprisoned not more than two years, or both. The department shall revoke the licenses of any person issued pursuant to the provisions of Article 19 of this chapter for a violation of subsection (C) of this section. Revocation is pursuant to the procedures set forth in Section 12-54-90.

(G)(1) In addition to any other penalties provided by law, the department, for a violation of Section 12-21-2808(E) or Section 12-21-2809, may:

(a) impose a civil penalty in an amount not to exceed five thousand dollars on the owner of the machine, or the person who obtained, or was required to obtain, the retail sales tax license for the place or premises pursuant to Section 12-21-2703, or both; and

(b) revoke the license of the machine giving rise to the violation and any other machine licensed to the same holder in any county where such machines are prohibited pursuant to Section 12-21-2809; and

(c) seize the offending machine and dispose of it as contraband.

(2) The penalties authorized by this subsection are effective immediately upon imposition and may not be stayed by any administrative or judicial action. The sole remedy available under this subsection is a hearing before the Administrative Law Judge Division on the question of the legality of the machine under Section 12-21-2809 and the reasonableness of the penalties imposed. Further appeals are as provided in Section 12-60-3380.

HISTORY: 1993 Act No. 164, Part II, § 19A; 1997 Act No. 53, § 3; 1999 Act No. 125, § 8.

§ 12-21-2805. [Repealed, effective July 1, 2000] Enforcement by the department or the division; enforcement by civil action.

(A) When the department or the division is notified in writing that an establishment, owner or distributor is or has been in violation of this article or Article 19 of this chapter and that one or more persons have notice or knowledge of a violation, the department or division shall have thirty days from the date of the receipt of the notice to initiate an enforcement action consistent with this chapter.

(B) If the department or division affirmatively declines to act or fails to initiate an enforcement action for the alleged violation within thirty days, the person or persons who have knowledge of the alleged violation may serve written notice upon the department of their intention to file a request for a proceeding to enforce the provisions of this chapter in the name of the department or division.

(C) Within thirty days of the receipt of the notice from the person or persons with knowledge of the alleged violation, the department or division shall forward the notice of intent to file a request for a proceeding to the Office of the Attorney General who shall determine:

(1) if the person or persons with knowledge of the violation has sufficient knowledge, expertise and experience to adequately represent the interests of the State, the department and the division in the action;

(2) if the person or persons with knowledge of the violation are willing to advance all costs and expenses to be incurred in the proceeding; and

(3) that the Office of the Attorney General will not pursue the enforcement of the alleged violation.

Upon written certification of the Office of the Attorney General that these conditions have been met, the person or persons with knowledge of the alleged violation may proceed to commence a civil action for any violation of any of the provisions of this chapter.

(D) If the Office of the Attorney General denies certification and fails to pursue enforcement within sixty days of notice or fails to act on a person's notice within thirty days of receipt, the person or persons with knowledge of a violation of this chapter may move to commence a civil action as provided herein.

(E) The civil action must be brought in the name of the State, and may be filed in any state court of competent jurisdiction. The person bringing the civil action may seek any fine or penalty that the State may seek.

(F) A copy of the complaint must be served on the Attorney General if he is not bringing the action, and the director, by the person bringing the action, either of whom may elect to join any action brought by the person.

(G) If the State, as determined by the Attorney General and the Governor acting together, joins with an action brought by a person under this section, the State, in addition to other fines or penalties, may request the suspension or revocation of licenses. The person shall receive at least fifteen percent but not more than twenty-five percent of the proceeds of the action or settlement of the claim, depending upon the extent to which the person substantially contributed to litigating the action. The person also shall receive an additional amount for reasonable expenses which the court finds to have been necessarily incurred, plus reasonable hourly attorney's fees and costs, to be paid by the defendant.

(H) If the State, as determined by the Attorney General and the Governor acting together, does not join with the action under this section, the person bringing the action or settling the claim shall receive an amount which the court decides is reasonable for collecting the civil penalty and revocation. The amount must not be less than twenty-five percent and must not be more than forty percent of the proceeds of the action or settlement, and must be paid out of the proceeds. The person also shall receive an additional amount for reasonable expenses which the court finds to have been necessarily incurred, plus reasonable hourly attorney's fees and costs, to be paid by the defendant.

(I) The State is not liable for expenses which a person incurs in bringing an action under this section.

(J) No settlement may be entered without approval by the department.

(K) Any determination in an action under this section that a licensee has violated a provision of this chapter is grounds for revocation of those licenses and the department may bring a subsequent action for suspension or revocation.

HISTORY: 1999 Act No. 125, § 19; 1999 Act No. 125, § 8.

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§ 12-21-2806. [Repealed] Referendum on allowing payouts for credits earned on coin-operated video games; results determined on county-by-county basis.

The cash payouts authorized by Section 16-19-60 of the 1976 Code relating to coin-operated devices may only be continued in any county in South Carolina after June 30, 1995, if a majority of the qualified electors of the county voting in a statewide referendum at the time of the 1994 general election vote in favor of the continued regulation and issuance of these licenses. The State Election Commission must place the question contained herein on the general election ballot in November, 1994. The state election laws shall apply to the referendum, mutatis mutandis. The State Board of Canvassers shall publish the results of the referendum within each county and certify them to the Secretary of State. If the result of this referendum is not in favor of a continuation of cash payouts for credits earned on coin-operated devices within the county, Section 16-19-60 of the 1976 Code shall not apply within such county after July 1, 1995.

If ~~a majority~~ of the qualified electors within a county vote to terminate cash payoffs for credits earned on coin-operated devices after July 1, 1995, the Tax Commission shall refund to any person holding a license for the operation of coin-operated devices, on a pro-rata basis, the portion of any license fees previously paid the commission for licenses which extend beyond July 1, 1995.

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The question put before the voters shall read as follows:

"Shall cash payouts for credits earned on coin-operated video game machines remain legal and subject to licensure and regulation by the State of South Carolina after June 30, 1995?"

[ ] Yes

[ ] No

HISTORY: 1993 Act No. 164, Part II, § 19G, effective July 1, 1993.

§ 12-21-2808. [Repealed, effective July 1, 2000] Counties allowed to hold referendum to determine whether or not to allow cash payoffs; restrictions on time of referendum; results.

(A) Counties may hold a referendum to determine whether or not cash payoffs are allowed for the operation of machines as defined in this article. The counties are authorized to hold this referendum in the manner provided in this section except that no such referendum may be held except at the time of the general election.

(B) The referendum must be held:

(1) upon the passage of an ordinance of the governing body of a county providing for a referendum if the ordinance is passed at least ninety days before a general election; or

(2) upon a petition so requesting filed with the county election department more than ninety days before the general election containing the signatures of at least ten percent, but not more than two thousand five hundred, of the qualified electors of the county as of the time of the preceding general election.

(C) In a county in which cash payoffs are permitted, at the time of the referendum provided for in this section, the question put before the voters shall read as follows:

"Shall cash payoffs for credits earned on coin-operated video game machines continue to be allowed in this county?"

Yes [ ]

No [ ]

(D) In a county in which, at the time of the referendum provided for in this section, cash payoffs are not authorized, the question put before the voters shall read as follows:

"Shall cash payoffs for credits earned on coin-operated video game machines be allowed in this county?"

Yes [ ]

No [ ]

(E) If the result of the referendum provided for in this section is not in favor of a continuation of cash payoffs for credits earned on coin-operated devices within the county,

cash payouts are prohibited within the county after June thirtieth of the year following the referendum.

(F) If the results of the referendum provided for in this section are to authorize cash payoffs, such payoffs are permitted, subject to the regulations of this article, within such county beginning January first of the year following the referendum.

(G) The state election laws apply to the referendum provided in this section, mutatis mutandis.

(H) If a majority of the qualified electors within a county vote to terminate cash payoffs for credits earned on coin-operated devices, in a referendum as authorized in this section, the department shall refund to any person holding a license for the operation of coin-operated devices on a pro rata basis, the portion of any license fees previously paid the department for licenses which extend beyond July first of the year after the referendum.

HISTORY: 1993 Act No. 164, Part II, § 19H; 1997 Act No. 53, § 4; 1999 Act No. 125, § 8.

§ 12-21-2809. [Repealed, effective July 1, 2000] Certain video games prohibited by referendum; licenses; penalty for violations.

(A) In a county in which a majority of the qualified electors vote or have voted to terminate cash payoffs for credits earned on coin-operated devices in a referendum

authorized by Section 12-21-2808, the department shall not issue any license for coin-operated devices as defined in Section 12-21-2720(A)(3) and a person may not own or possess these machines in the county other than for purposes of storage, maintenance, or transportation.

(B) A person who owns or possesses any coin-operated device in violation of subsection (A) of this section is subject to the penalties provided in Section 12-21-2804(G).

HISTORY: 1995 Act No. 145, Part II, § 67A; 1997 Act No. 53, § 5; 1999 Act No. 125, § 8.

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CODE OF LAWS OF SOUTH CAROLINA
1976 ANNOTATED
TITLE 16. CRIMES AND OFFENSES
CHAPTER 19. GAMBLING AND LOTTERIES

§ 16-19-60. [Repealed] Legality of coin-operated nonpayout machines with free play feature.

Nothing in Section 16-19-40 or 16-19-50 shall extend to coin-operated nonpayout machines with a free play feature; provided, that nothing herein shall authorize the licensing, possession, or operation of any machine which disburses money to the player. Nothing in this section prohibits regulation of video games pursuant to Article 20, Chapter 21 of Title 12, the Video Games Machines Act, including the prohibition on payoffs and location of these machines in counties where such payouts and machines are prohibited under the local option provisions of that article.

HISTORY: 1962 Code § 16-505.1; 1975 (59) 333.

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No. 01-1139

In The
Supreme Court of the United States

RICK'S AMUSEMENT, INC., et al.

Petitioners,

vs.

STATE OF SOUTH CAROLINA,

Respondent.

On Petition For A Writ Of Certiorari
To the South Carolina Supreme Court

Respondent's Brief In Opposition to Petition for Writ of Certiorari

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QUESTIONS PRESENTED

South Carolina Code Ann. Section 12-21-2806 provided for a statewide referendum held during South Carolina's general elections in November 1994 that permitted the registered electors in each county in South Carolina to vote, and to determine by their vote, whether to terminate cash payouts for credits earned on coin-operated devices operated in the county. The question presented is whether the decision by voters in twelve of South Carolina's forty-six counties to terminate cash payouts on coin-operated devices constituted a taking of Petitioners' property for which just compensation is due under the United States Constitution or an unconstitutional impairment of Petitioners' contracts relating to the placement of coin-operated devices such as video poker machines in commercial establishments.

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OPINION BELOW

The opinion of the South Carolina Supreme Court (Pet. App. 1a-12a) is not yet officially reported.

JURISDICTION

The judgment of the South Carolina Supreme Court was entered on November 5, 2001. The jurisdiction of this Court is invoked by petitioners under 28 U.S.C. § 1257(a).

COUNTER STATEMENT OF THE CASE

These consolidated cases involve claims brought by several South Carolina corporations who were in some manner involved in the now-defunct video gambling industry in South Carolina. Petitioners comprise two groups of businesses: those who owned, maintained, repaired, or serviced video poker machines and those who owned or leased commercial establishments in which one or more such machines were placed pursuant to a contract with the machines' owners.

To understand the relevant background of this case, it is necessary to know something of the history of video poker in South Carolina. For nearly two centuries, slot machines and other forms of gambling have been illegal in South Carolina. These illegal gambling devices are subject to seizure and destruction. S.C. Code Ann. § 12-21-2712 (Supp. 2001).

In 1975, the South Carolina legislature added a provision to the state's anti-gambling laws that authorized the playing of "coin-operated nonpayout machines with a free play feature." 1975 S.C.

Act No. 237, Part II, § 4 (codified at S.C. Code § 16-19-60 (1976)). This provision was inserted without fanfare in the permanent provisions of the State appropriations act, and was not seen at the time as inaugurating widespread gambling in the State, since the language expressly continued the ban on "any machine which disburses money to the player." However, in 1991, the South Carolina Supreme Court construed this statute to mean that, while it was illegal for a video game *machine* itself to disburse money to a player, it was not illegal for a *person* (such as an arcade owner) to disburse money to a player as "payment" for the free plays that the player had won using such a machine. *See State v. Blackmon*, 403 S.E.2d 660, 662 (S.C. 1991) (per curiam).

In the interim, the General Assembly passed another provision in 1982 which expressly authorized, for the first time, the operation and possession of "video games with a free play feature." 1982 S.C. Act No. 466, Part II, § 14 (codified as amended at S.C. Code Ann. §12-21-2710 (Supp. 1999)). The South Carolina Supreme Court determined that this provision, when read in conjunction with S.C. Code § 16-19-60, insulated the video poker machines from seizure and destruction, to which they would otherwise have been subject. *See Powell v. Red Carpet Lounge*, 311 S.E.2d 719 (S.C. 1984).

In the wake of these rulings, video poker in South Carolina grew into a multi-billion dollar industry and became the subject of intense local debate. In a 1999 opinion, the Fourth Circuit Court of Appeals astutely observed that "[v]ideo poker has arguably been the most hotly contested issue in South Carolina in recent years." *See Johnson v. Collins Entertainment Co., Inc.*, 199 F.3d 710, 715 (4th Cir. 1999).

The industry was also the subject of extensive regulation. In determining that the federal courts should abstain from deciding the claims before it in *Johnson*, the Fourth Circuit noted that "South Carolina has employed a variety of legislative, administrative, and

judicial mechanisms to regulate this multi-billion dollar business. These mechanisms constitute an interdependent state network aimed at the comprehensive regulation of video poker." *Id.*

In 1993, the South Carolina General Assembly enacted legislation providing for a statewide referendum to permit the qualified electors of each county to vote and determine by their vote whether to terminate cash payouts for credits earned on coin-operated devices in their county. *See* S.C. Act No. 164, Part II, § 19H; S.C. Code Ann. § 12-21-2806 (Supp. 1995). It is this legislation which forms the basis of Petitioners' present claim. In the general election in November 1994, the majority of voters in twelve of South Carolina's forty-six counties chose to ban cash payouts for credits earned on coin-operated devices. Pursuant to the referendum, in those twelve counties it became unlawful after June 30, 1995 to use or possess a video game machine, as that term was defined in the statute, other than for purposes of storage, maintenance, or transportation. This prohibition remained in effect in those twelve counties from July 1, 1995 until November 4, 1996, when the South Carolina Supreme Court struck down this legislation as special legislation inconsistent with provisions in the state constitution requiring criminal laws to be uniform statewide. *See Martin v. Condon*, 478 S.E.2d 272 (S.C. 1996).

Following the issuance of the *Martin* decision, video poker returned for a time to the twelve counties that had voted to ban cash payouts. Ultimately, however, South Carolina banned video poker altogether. S.C. Code Ann. § 12-21-2710, as amended by 1999 S.C. Act 125, Part I, § 1 (effective July 1, 2000). Since July 1, 2000, video gambling machines are once again completely illegal in South Carolina. Under current law, it is illegal to possess or use these machines in the State. S.C. Code Ann. § 12-21-2710 (Supp. 2001). If found in the State, the machines are subject to seizure and destruction. S.C. Code Ann. § 12-21-2712 (Supp. 2001).

Not surprisingly, owners and lessees of video poker

machines challenged Act 125 on the grounds that it took their property without just compensation. The South Carolina Supreme Court held that Act 125 did not take the owners' video poker machines, their businesses, or the real property on which the businesses were located. *Westside Quik Shop, Inc. v. Stewart*, 534 S.E.2d 270 (S.C.), *cert. denied*, 531 U.S. 1029 (2000). This Court denied certiorari.

Meanwhile, Petitioners brought this suit seeking "to recover losses allegedly incurred by the local option law and the resulting cash payout ban." (Pet. App. 4a). Petitioners alleged that they signed contracts for placement of video poker machines in commercial establishments prior to the passage of the legislation permitting the referendum struck down in *Martin*. The State moved to dismiss Petitioners' claims for failure to state a claim on which relief can be granted under Rule 12(b)(6) of the South Carolina Rules of Civil Procedure. The trial court granted the State's motion to dismiss. (Pet. App. 13a-19a).

Both Petitioners and Respondent appealed the trial court's order. Petitioners, obviously, appealed the trial court's dismissal of their case. The State appealed those portions of the trial court's order that had denied some of the aspects of the State's motion to dismiss. However, because under South Carolina law rulings made by a trial court in denying a motion to dismiss are not "the law of the case" and the ruling does not preclude a party from raising the issue at a later point or points in the case, *see, e.g.*, *Hutley v. Young*, 462 S.C. 860 (S.C. 1995), the State later decided to withdraw its appeal.

The South Carolina Supreme Court affirmed the trial court's Order dismissing Petitioner's claims, relying heavily on its previous decision in a factually similar case. *See Mibbs v. Department of Revenue*, 524 S.E.2d 626 (S.C. 1999). The court first addressed Petitioners' takings claim. Petitioners claimed that "the invalid local option law 'revoked and/or impounded [their] contracts' for the placement of video gaming machines, thereby constituting a taking."

(Pet. App. 8a-9a). The court expressly "agree[d] with [Petitioners] that a plaintiff who operates in an heavily regulated industry is not prohibited from establishing the existence of a property interest protected by the Fifth Amendment." (Pet. App. 8a). However, the court held that Petitioners' right to own or possess video gaming machines did not include any inherent "right" to continued cash payouts. (Pet. App. 9a). Rather, Petitioners' "rights to continued cash payouts were completely dependent upon regulatory licensing." *Id.*

The court next addressed Petitioners' claim that the local option law impaired their contracts. The court concluded that, given the climate in the State with respect to the legality of video poker, the ban on cash payouts could not have operated as a substantial impairment of the reasonable expectations of the contracting parties. The court stated that its decision was based upon the "unique environment" of regulation in South Carolina relating to video gambling, and would "not affect the certainty of contracts in highly regulated fields" like banking and insurance. (Pet. App. 11a). The court thus made clear that its decision was very specific to the video poker industry.

REASONS FOR DENYING THE WRIT

The decision of the South Carolina Supreme Court is correct and does not conflict with the decisions of this Court, any federal court of appeals, or any other state court of last resort. Moreover, this case involves an area of core state policy concern and does not present any issue of broad federal importance. Further review is therefore not warranted.

I

THIS CASE DOES NOT PRESENT ANY COMPELLING REASON TO GRANT A PETITION FOR WRIT OF CERTIORARI BECAUSE THERE IS NO IMPORTANT FEDERAL QUESTION DECIDED BELOW THAT CONFLICTS WITH RELEVANT DECISIONS OF THIS COURT, A UNITED STATES COURT OF APPEALS, OR ANOTHER STATE COURT OF LAST RESORT

The decision below does not conflict with any decision of this Court, a United States Court of Appeals, or another state court of last resort. Petitioners misstate the holding of the South Carolina Supreme Court and overstate the existence of an alleged "conflict" among courts in arguing that certiorari should be granted.

Petitioners assert that "courts are divided on whether businesses in highly regulated areas have the cognizable property interests required in takings and contract impairment cases." (Pet. 10). Neither the South Carolina Supreme Court nor any other court cited by Petitioners has held that businesses in highly regulated fields are categorically barred from asserting takings and contract impairment cases. On the contrary, in deciding the case below, the South Carolina Supreme Court expressly "agree[d] with [Petitioners] that a plaintiff who operates in an heavily regulated industry is not prohibited from establishing the existence of a property interest protected by the Fifth Amendment." (Pet. App. 8a). The court

emphatically did **not** hold that "a highly regulated industry has no cognizable property rights under the Takings and Contracts Clauses" as asserted by Petitioners. (Pet. 2). Rather, the court inquired into the nature of the property interest asserted by Petitioners and determined that whatever rights Petitioners had to own or possess video poker machines did not inherently include the right to make cash payouts to users of the machines. (Pet. App. 9a).

Moreover, lower courts are not divided on whether "a sweeping 'heavily-regulated industry' exception to cognizable property rights in takings claims" exists, as asserted by Petitioners. (Pet. 17). The opinions relied upon by Petitioners to demonstrate a conflict are fully consistent with one another and with the opinions of this Court, as discussed below.

In concluding as an initial matter that Petitioners had no "property right" to continue making cash payouts, the court below relied upon decisions of the Federal Claims Court and the Court of Appeals for the Federal Circuit. The Federal Circuit has adopted a two-tiered approach to determining whether a regulation constitutes a taking requiring just compensation. *See, e.g., M & J Coal v. United States*, 47 F.3d 1148, 1153-54 (Fed. Cir.), *cert. denied*, 516 U.S. 808 (1995). First, the court determines whether the plaintiff has a property interest within the meaning of the Fifth Amendment. *Id.* at 1154 (citing *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992)). Second, if a property interest is found, the court then determines whether the governmental action at issue constituted a compensable taking. *Id.* In making this determination, the court performs an *ad hoc* factual inquiry into "the character of the governmental action, the economic impact of the regulation on the claimant, and the extent to which the regulation has interfered with the claimant's distinct investment-backed expectations." *Id.* (citing *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978)). The Federal Circuit and the Court of Claims have consistently employed this analysis in cases where the asserted "property right" is not traditionally recognized. *See, e.g., Allied*

General Nuclear Services v. United States, 839 F.2d 1572 (Fed. Cir.), *cert. denied*, 488 U.S. 819 (1988) (corporation's expectation of being awarded a license to operate a nuclear power reprocessing plant was not a property right protected by Fifth Amendment); *Mitchell Arms v. United States*, 7 F.3d 212 (Fed. Cir. 1993), *cert. denied*, 511 U.S. 1106 (1994) (expectation of selling assault rifles in domestic commerce was not a right inherent in ownership of rifles but was totally dependent upon import permits); *Conti v. United States*, 48 Fed. Cl. 532 (2001) (federal swordfish fishing permit does not confer a compensable property right in continued use of prohibited gillnet gear).

Petitioners repeatedly use terms such as "subvert," "repudiate," "side-step," "circumvent," "avoid," and "short-circuit," to describe this line of decisions with respect to this Court's takings jurisprudence. (Pet. 10, 11, 12, 19, 21). On the contrary, as discussed more fully below, the approach employed by these courts is fully consistent with the precedents of this Court, which have always necessarily required that a property owner actually own the property interest allegedly proscribed. *See, e.g., Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1000-04 (1984) (first step in analysis is to determine whether Monsanto has a property interest in the data submitted to the EPA); *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 55 (1986) ("[T]he 'contractual right' at issue in this case bears little, if any, resemblance to rights held to constitute 'property' within the meaning of the Fifth Amendment."). In *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1027 (1992), this Court held that even restrictions on the use of land, which are traditionally viewed much more critically than restrictions on personal property, require a "logically antecedent inquiry into the nature of the owner's estate" to determine whether "the proscribed use interests were . . . part of his title to begin with." In some respects, this "logically antecedent inquiry" (hence the "two-tiered" approach of the claims courts) is analogous to the question of standing: obviously, the government

cannot "take" something that the citizen does not own.

This Court has repeatedly declined opportunities to review these federal decisions applying a two-tiered analysis to takings claims. *See, e.g., M & J Coal v. United States*, 47 F.3d 1148, 1153-54 (Fed. Cir.), *cert. denied,* 516 U.S. 808 (1995); *Mitchell Arms v. United States*, 7 F.3d 212 (Fed. Cir. 1993), *cert. denied*, 511 U.S 1106 (1994); *Allied General Nuclear Services v. United States*, 839 F.2d 1572 (Fed. Cir.), *cert. denied,* 488 U.S. 819 (1988). Respondent does not suggest that these denials of certiorari have precedential import. Rather, Respondent suggests that any alleged error in the federal claims courts' analysis would be more appropriately corrected by review of one of these federal decisions, rather than through a state case involving an area of core state policy concern such as the instant case.

In any event, Petitioners have not demonstrated that the decision below conflicts with a decision of another state court of last resort, a United States Court of Appeals, or this Court on an important federal question. Petitioners instead rely upon assertions of a generalized conflict among courts as to the legitimacy of the two-tiered approach to takings cases. In support of their position that a conflict exists which requires resolution by this Court, Petitioners rely almost exclusively on *Maritrans, Inc. v. United States*, 40 Fed. Cl. 790 (1998). *Maritrans* is an inappropriate vehicle to demonstrate a conflict because it is not a decision of a United States Court of Appeals so as to implicate Supreme Court Rule 10.

Moreover, *Maritrans* is not in conflict with the decisions of other courts, including that of the South Carolina Supreme Court in the instant case. In *Maritrans*, the owners of single-hulled tank barges sued the United States alleging that the Oil Pollution Act of 1990 effected a taking of their property without just compensation by requiring that all single-hulled vessels be retrofitted with double hulls. The court uncritically applied the

two-tiered approach adopted by the Federal Circuit. *Id.* at 793. The government did apparently propound the "theory that the regulated nature of the industry precludes a cognizable Fifth Amendment property interest." *Id.* at 797. However, the court properly rejected that theory as inconsistent with prior decisions of this Court and of the Federal Circuit and Court of Claims, including *Mitchell Arms*, with which Petitioners assert *Maritrans* conflicts. The *Maritrans* court applied the two-tiered analysis and concluded, under the first tier, that "[i]nherent in the ownership of the vessels is the right to use them." *Id.* at 799. The court distinguished *Mitchell Arms* and *Allied General* on their facts. *Id.* at 795-96. Having found a cognizable property interest, the court proceeded in subsequent opinions to address the *Penn Central* factors, ultimately concluding that the government had not taken plaintiff's property. *Maritrans v. United States*, 51 Fed. Cl. 277 (2001).

Other cases relied upon by Petitioners to support their assertion of a conflict include *Golden Pacific Bancorp v. United States*, 15 F.3d 1066 (Fed. Cir.), *cert. denied*, 516 U.S. 961 (1994) and *United Nuclear Corp. v. United States*, 912 F.2d 1432 (Fed. Cir. 1990). These decisions are not evidence of a conflict among courts since they were decided by the same court with which they supposedly conflict – the Court of Appeals for the Federal Circuit. In any event, these decisions, like *Maritrans*, are fully consistent with the present case. In *Golden Pacific*, the court held that the Controller's actions of declaring the bank insolvent and placing it in FDIC receivership did not constitute a compensable taking under the Fifth Amendment. The court concluded Golden Pacific's ownership of the bank did not include "*either* the historically rooted expectation of compensation *or* the reasonable investment-backed expectation necessary to support a Fifth Amendment taking claim." 15 F.3d at 1076 (emphasis added). In *United Nuclear*, the court found a Fifth Amendment taking in an agency action dispossessing the claimant's leasehold interest in Indian lands. *United Nuclear* was fundamentally

different from the instant case – and from *Mitchell Arms*, *Allied General*, etc. – in that the property interest taken was a leasehold interest in real property. 912 F.2d at 1437.

Petitioners also cite *Woodland Manor III Associates v. McLeod*, 2000 WL 276820, *5 (R.I. Super. Mar. 2, 2000), as evidence of a conflict requiring this Court to grant certiorari. *Woodland Manor* is not a decision of a state court of last resort, and is thus irrelevant to the existence of a conflict under this Court's rules. U.S. S. Ct. R. 10. In any event, the Rhode Island Supreme Court has remanded that case to the lower court for reconsideration in light of *Palazzolo v. Rhode Island*, 533 U.S. 606 (2001).

Finally, in *Colorado Dep't of Health v. The Mill*, 887 P.2d 993, 1002 (Colo. 1995), *cert. denied*, 515 U.S. 1159 (1995), cited at Pet. 16 and 19, the court found no taking because the challenged regulation merely implemented restrictions on land use that inhered in the plaintiff's title under the Colorado common law of nuisance. The opinion does not address the validity of the two-tiered approach.

Petitioners do not establish the existence of any conflict between the decision below, on the one hand, and those of any lower federal court or other state court of last resort, on the other hand, that would warrant this Court's review. Even assuming a generalized conflict among courts – which Respondent respectfully submits does not exist – Petitioners have not established that the court below decided an important federal question in the present case in a way that conflicts with the decision of another state court of last resort, a United States Court of Appeals, or this Court.

II

THE SOUTH CAROLINA SUPREME COURT CORRECTLY DETERMINED THAT THE BAN ON VIDEO POKER CASH PAYOUTS DID NOT CONSTITUTE A TAKING OF PETITIONERS' PROPERTY OR AN UNCONSTITUTIONAL IMPAIRMENT OF PETITIONERS' CONTRACTS

A. The Court Below Correctly Determined that the Ban on Video Poker Cash Payouts Did Not Take Petitioners' Property.

Petitioners claim that the sixteen-month ban on cash payouts in twelve South Carolina counties caused a taking of their property without just compensation. The court below correctly rejected that claim because no "property" belonging to Petitioners was "taken." Petitioners' attempt to characterize the statute at issue as an unconstitutional regulation of property is unavailing. Clearly, the statute at issue was merely a police power prohibition on gambling activities that cannot support a takings claim.

The Takings Clause of the Fifth Amendment provides: "[N]or shall private property be taken for public use without just compensation." U.S. Const. Amend. V. This provision is made applicable to the states through the Fourteenth Amendment. *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 499 U.S. 155, 160 (1980).

First, as to the existence of "property," the State has never contended that the mere fact of heavy regulation, in and of itself, would preclude in all cases a finding that a property interest exists. However, a court cannot logically determine whether property has been taken without identifying the property allegedly taken. The Fifth Amendment concerns itself solely with "property," *i.e.*, with the owner's relation as such to the physical thing and not

with other collateral interests which may be incident to ownership. *United States v. General Motors Corp.*, 323 U.S. 373, 378 (1945). A collateral interest has been defined as a right not inherent in the ownership of the physical property. *Mitchell Arms v. United States*, 7 F.3d 212, 217 (Fed. Cir. 1993), *cert. denied*, 511 U.S. 1106 (1994).

Petitioners acknowledge that "it appears unquestioned that property rights dependent on an Act of Congress are subject to later amendments of the relevant statutory scheme." (Pet. for Cert. p. 15) (citing *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 55 (1986)); *see also Connolly v. Pension Benefit Guarantee Corp.*, 475 U.S. 211 (1986) ("Contracts may create rights of property, but when contracts deal with a subject matter which lies within the control of Congress, they have a congenital infirmity.") (quoting *Norman v. Baltimore & Ohio R. Co.*, 294 U.S. 240, 307-08 (1935)). Likewise, a "right," such as it is, created solely by the State's issuance of a license pursuant to a statutory scheme is subject to the State's power to alter the relevant statutory scheme. *See id.*

Mitchell Arms is highly analogous to the present case. The plaintiff in that case was a federally-licensed firearms importer who claimed a taking when the Bureau of Alcohol, Tobacco and Firearms banned the style of weapons that the plaintiff had imported. *Id.* at 213-214. The Federal Circuit rejected plaintiff's argument that because it had import permits to import the guns, it had a protected property interest that could not be taken away without just compensation. *Id.* at 215-16.

Like *Mitchell Arms*, the present case involves an area of key government concern and control. Constitutional and statutory prohibitions on gambling have deep historical roots and are unquestionably valid. As noted by this Court in *Ah Sin v. Wittman*, 198 U.S. 500, 505-06 (1905): "The suppression of gambling is concededly within the police powers of a state, and legislation prohibiting it, or acts which may tend to or facilitate it,

will not be interfered with by the court unless such legislation be a clear, unmistakable infringement of rights secured by the fundamental law." (internal quotations omitted).

Moreover, Petitioners' argument that the State "revoked and/or impounded their contracts" for the placement of video poker machines in commercial establishments, constituting a compensable taking (Pet. 4), is misplaced. As Petitioners acknowledge, this case involves no regulation of real property, nor any physical confiscation of personal property. On the contrary, the State merely permitted the voters of each county to determine whether to permit cash payouts to players of video poker machines. The effect of the law was not to "take property," but to prohibit certain gambling activities. As this Court has previously held, Petitioners cannot create a property interest, and manufacture a takings claim, by making a contract relating to activities that are well within the State's power to prohibit. *See Hudson Water Co. v. McCarter*, 209 U.S. 349, 357 (1908) ("One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the State by making a contract about them."). In short, the state took nothing belonging to Petitioners.

Petitioners acknowledge that "in certain situations, it may be required for a court to analytically split the question of a claimant's cognizable property interests from the wider context of the impact of regulation on those rights, the claimant's investment-backed expectations, and the character of the governmental action." (Pet. 13). However, Petitioners assert, "the South Carolina Supreme Court's decision purports to allow this deflection from the *Penn Central* analysis in most, if not all, circumstances." (Pet. 13). This contention completely mischaracterizes the South Carolina Supreme Court's holding, which was very fact specific and clearly addressed to the now-illegal video gambling industry. (Pet. App. 11a).

Moreover, the South Carolina Supreme Court's opinion is consistent with the *Penn Central* analysis. In determining whether a taking has occurred, this Court has outlined three factors that must be considered. The three factors are (1) the economic impact of the regulation on the claimant; (2) the extent to which the regulation has interfered with distinct investment-backed expectations; and (3) the character of governmental action. *Penn Central*, 438 U.S. at 124. Considering these factors in reverse order, this Court has previously noted that the "nature of the government action is the critical factor in a takings analysis." *Keystone Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987).

The character of the governmental action here is a classic exercise of the police power. In *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211 (1986), the plaintiffs argued that Congress' enactment of a regulatory scheme affecting the plaintiffs' pension fund resulted in a taking requiring just compensation. Rejecting this contention, this Court noted that the government interference with the contract at issue "arises from a program that adjusts the benefits and burdens of economic life to promote the common good, and under our cases, does not constitute a taking requiring government compensation." *Id.* at 224. The Court stressed that the United States had "taken nothing for its own use, and only has nullified a contractual provision limiting liability by imposing an additional obligation that is otherwise within the power of Congress to impose." *Id.* The Court noted that "the fact that legislation disregards or destroys existing contractual rights does not always transform the regulation into an illegal taking." *Id.*; *see also Mugler v. Kansas*, 123 U.S. 623 (1887) (no taking even though the state passed legislation that prohibited the plaintiff from engaging in a business that had been established before the law was passed).

Likewise, the character of the governmental action in the instant case is completely consistent with the exercise of the

State's police powers. The State took nothing for its own use, but merely authorized the electors in each county in South Carolina to decide whether to restrict gambling activities within the county, an action unquestionably within the State's police power.

The next factor for consideration is the economic impact of the regulation. The only economic impact of the complained of regulation on Petitioners was lost business profits. As this Court emphasized in *Andrus v. Allard*, 444 U.S. 51, 66 (1979), "loss of future profits – unaccompanied by any physical property restriction – provides a slender reed upon which to rest a takings claim." In *Andrus*, this Court held no taking occurred when Congress passed the Eagle Protection Act, which prohibited commercial transactions in parts of birds protected by the Act. The court noted that "the interest in anticipated gains has traditionally been viewed as less compelling than other property-related interests." *Id.* Moreover, any alleged diminution in the value of Petitioner's property would not constitute a taking. *See Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California*, 508 U.S. 602, 646 (1993) ("our cases have long established that mere diminution in the value of property, however serious, is insufficient to demonstrate a taking"); *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 413 (1922) ("Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law.").

The final factor to be considered is the extent to which the regulation has interfered with reasonable investment-backed expectations of the parties. The extent and degree of regulation is particularly relevant to this inquiry. *See Connolly*, 475 U.S. at 227 ("Those who do business in the regulated field cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end.").

The State's position is even stronger – and Petitioner's position concomitantly weaker – where, as here, the personal property at issue is the subject of unquestionable government control. As noted, courts have repeatedly held that the State has a legitimate interest in controlling gambling activities. Given the State's historical high degree of control over gambling, Petitioners could have no reasonable expectation that cash payouts would continue to be legal. Any investments made in the expectation of the continued legality of such payouts were purely speculative.

Additionally, Petitioners inaccurately characterize the ban on cash payouts as a "total ban on their business activities from July 1995 to November 1996." (Pet. 4). Presumably, Petitioners mean by this to invoke the *per se* doctrine of *Lucas* which arises when a regulation deprives an owner of all economically beneficial use of his property. *See Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992). Significantly, however, Petitioners' video poker machines were not confiscated, Petitioners could still sell those machines or use them in the thirty-four counties in the state in which cash payouts remained legal, and Petitioners could have avoided the alleged forfeiture of their machines by disposing of their property prior to the date the ban on cash payouts was to take effect. *See Hamilton v. Kentucky Distilleries & Warehouse Co.*, 251 U.S. 146 (1919) (rejecting takings claim involving wartime restriction on domestic sale of liquor that had delayed effective date, which gave distilleries seven months to sell their liquor without restrictions).

With respect to the Petitioners who are alleged owners and/or operators of commercial establishments, these Petitioners could continue to use their businesses and the real property on which those businesses stood for any legal purpose. Moreover, Petitioners' contracts to place video poker machines in their establishments in these counties were contracts relating to "pure contraband" – "objects the possession of which, without more,

constitutes a crime." *Bennis v. Michigan*, 516 U.S. 442, 459 (1996) (Stevens, J., dissenting). Indeed, these gambling devices fall squarely within the types of property that have traditionally been classified as contraband subject to forfeiture. *See, e.g., Lawton v. Steele*, 152 U.S. 133, 136, 142 (1894) (treating "articles used for gambling purposes" as traditionally within a state's power to forfeit). As noted above, Petitioners cannot create a takings claim simply by making a contract relating to these devices. *Hudson Water Co.*, 209 U.S. at 357; *see also Lucas*, 505 U.S. at 1027-28 ("[I]n the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, [a property owner] ought to be aware of the possibility that new regulation might even render his property commercially worthless (at least if the property's only commercially productive use is sale or manufacture for sale).") (citing *Andrus v. Allard*, 444 U.S. 51 (1979)).

Finally, the South Carolina Supreme Court's determination in *Martin* that the referendum on cash payouts violated South Carolina's constitution because the prohibition on cash payouts did not apply statewide is of no import in considering Petitioners' claims. Petitioners cite no authority for the proposition that the subsequent declaration of the statute's unconstitutionality results, necessarily, in a finding that a taking or impairment of contract occurred. Clearly, this suggested result is not advisable. As noted by one state Supreme Court, "[f]or a court to hold a state liable for unconstitutional legislation would introduce a profound conservative tilt into the lawmaking process. Legislators would become reluctant to legislate, knowing that money damages were at stake if a court ultimately disagrees with their appraisal of the constitutionality of a bill." *Vest v. Shafer*, 757 P.2d 588 (Alaska 1988), *cert. denied*, 491 U.S. 904 (1989).

This is particularly true where, as here, Petitioners conceded before the South Carolina Supreme Court that the State could (as it ultimately did) completely ban the video gaming

industry and no compensation would be due. (Pet. App. 10a n. 4). *See Westside Quik Shop, Inc. v. Stewart*, 534 S.E.2d 270 (S.C.) *cert. denied*, 531 U.S. 1029 (2000). It would be strange indeed to permit Petitioners to pursue claims for damages in this case simply because the method chosen by the General Assembly was held to be invalid under State law, for reasons completely unrelated to the law's substantive validity, when Petitioners acknowledge that had the ban on cash payouts been applied statewide they would have no basis for any claim.

Accordingly, Petitioners have not established their entitlement to compensation under any theory. Moreover, even if this Court disapproves of the two-tiered analysis of the federal claims courts, followed by the South Carolina Supreme Court in this case, the Court should nevertheless deny the petition for certiorari. Because of the nature of the purported property interest involved in this case, and the strong State interest in controlling gambling activities, this case presents a poor vehicle for the correction of any asserted analytical errors on the part of courts adjudicating takings claims.

B. The Court Below Correctly Determined that the Ban on Video Poker Cash Payouts Did Not Unconstitutionally Impair Petitioners' Contracts.

The Contracts Clause of Art. I, § 10, provides that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts." Despite the unequivocal language of this passage, "it is well settled that the prohibition against impairing the obligation of contracts is not to be read literally." *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 502 (1987). "The Contract Clause does not deprive States of their broad power to adopt general regulatory measures without being concerned that private contracts will be impaired, or even destroyed, as a result." *Exxon Corp. v. Eagerton*, 462 U.S. 176, 191 (1983). Instead, the Constitutional prohibition on impairment of the obligations of

contracts "must be accommodated to the inherent police power of the State to safeguard the vital interests of its people." *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*, 459 U.S. 400, 410 (1983) (citing *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 434 (1934)). In determining whether a statute violates the Contracts Clause, this Court "balance[s] the language of the Contract Clause against the State's interest in exercising its police power." *Energy Reserves Group*, 459 U.S. at 410.

The threshold inquiry is whether the state law has, in fact, operated as a substantial impairment of a contractual relationship. *Id.* at 411. An important consideration in determining the extent of the impairment is whether the affected industry has been regulated in the past. *Id.; see also Veix v. Sixth Ward Bldg. & Loan Ass'n*, 310 U.S. 32, 38 (1940) ("When he purchased into an enterprise already regulated in the particular to which he now objects, he purchased subject to further legislation upon the same topic."). If the regulation at issue is found to constitute a substantial impairment, "the State, in justification, must have a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and general social or economic problem." *Id.* at 411-12 (internal citations omitted). This requirement "guarantees that the State is exercising its police power, rather than providing a benefit to special interests." *Id.* at 412.

Finally, assuming a significant and legitimate public purpose has been identified, "the next inquiry is whether the adjustment of the rights and responsibilities of contracting parties is based upon reasonable conditions and is of a character appropriate to the public purpose justifying the legislation's adoption." *Id.* at 412 (internal quotations omitted). "Unless the State itself is a contracting party, as is customary in reviewing economic and social regulation, courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure." *Id.* at 412-13 (internal quotations and

citations omitted).

In *Energy Reserves Group*, this Court held that a natural gas supplier's intrastate contracts with public utilities, containing governmental price escalator and price redetermination clauses, were not impaired, in violation of the contract clause, by a Kansas statute which prohibited consideration either of ceiling prices set by federal authorities or of prices paid in Kansas under other contracts in application of indefinite price escalators. In determining the statute did not unconstitutionally impair the contracts, the Court placed great emphasis on the state's "extensive and intrusive" regulation of the natural gas industry. *Id.* at 413-14. Because price regulation was foreseeable, the Act did not impair the plaintiff's reasonable expectations and therefore did not operate as a substantial impairment of its contracts. *Id.* at 414. The Court reached this result despite the fact that Kansas had not previously regulated natural gas prices specifically. *Id.* at 413.

As in *Energy Reserves Group*, and perhaps even more so, the contracts at issue in the present case involve an area that has historically been the subject of vast state control. Like this Court in *Energy Reserves Group*, the South Carolina Supreme Court, relying on its earlier decision in *Mibbs v. South Carolina Dep't of Revenue*, 524 S.E.2d 626 (S.C. 1999), determined the ban on cash payouts for video poker did not operate as a substantial impairment of the parties' contracts for placement of video poker machines. Not only was the video poker industry the subject of extensive regulation, but the parties entered into their contracts in a period during which "lawmakers repeatedly introduced legislation specifically aimed at eliminating nonmachine cash payouts." (Pet. App. 11a). Given this "unique environment," Petitioners could not expect to insulate themselves against such legislation by making contracts relating to video poker machines. *See Hudson Water Co. v. McCarter*, 209 U.S. 349, 357 (1908) ("One whose rights, such as they are, are subject to state

restriction, cannot remove them from the power of the State by making a contract about them."); *see also Beer Co. v. Massachusetts*, 97 U.S. 25 (1878) (state prohibition laws may be applied to contracts for the sale of beer and wine that were valid when entered into); *Stone v. Mississippi*, 101 U.S. 814 (1879) (the state may pass a law barring lotteries and apply that law to lottery tickets that were valid when issued).

Petitioners assert that the court below erred in considering only the first step in the Contracts Clause analysis. (Pet. 24). The State respectfully submits that, on the contrary, if a regulation does not substantially impair a contract, there is no reason for further analysis. However, assuming for purposes of argument that the lower court should have examined the remaining factors, it is clear that Petitioners' claim would fail under them as well. The State unquestionably has a significant and legitimate public purpose in regulating – or even prohibiting – gambling activities. *See, e.g., Stone*, 101 U.S. at 818 ("If lotteries are to be tolerated at all, it is no doubt better that they should be regulated by law, so that the people may be protected as far as possible against the inherent vices of the system."). Moreover, the ban on cash payouts was "based upon reasonable conditions" and was "of a character appropriate to the public purpose justifying the legislation's adoption." *Energy Reserves Group*, 459 U.S. at 412. The legislation at issue merely allowed counties to permit or prohibit cash payouts to players of video poker machines. This minimal restriction was certainly reasonable and appropriate to the State's purpose of restricting gambling activities in the State, and therefore does not constitute a violation of the Contracts Clause under this Court's precedents.

CONCLUSION

Respondent submits that Petitioners have framed a question to this Court that does not require an answer. The State of South Carolina does not contend, and its Supreme Court has

not held, that businesses operating in highly regulated fields are categorically barred from establishing takings claims. The court below correctly applied well-settled precedents of this Court to conclude that Petitioners did not establish a taking of property requiring just compensation or an unconstitutional impairment of their contracts. Moreover, this case does not present an appropriate case for this Court's review because it concerns an area of core state policy concern, rather than a broadly applicable federal question. Further, Petitioners have not established the existence of a conflict among courts requiring resolution. It is therefore respectfully submitted that the petition for writ of certiorari should be denied.

Respectfully submitted,

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